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THE IMPACT OF ICELAND’S PREFERENTIAL FREE TRADE AGREEMENTS WITH PARTNERS OUTSIDE THE EUROPEAN ECONOMIC AREA ON TRADE FLOWS

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Foreword

This thesis is the final assignment towards a M.Sc. degree in International Business at Reykjavik University. The assessment of this thesis is 30 ECTS credits. The writing took place in the period of February to May 2013.

The author would like to thank the following:

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Abstract

Iceland has made free trade arrangements that include 65 different countries. The single largest group of countries is the EU and EEA-EFTA partners through the EEA agreement, undoubtedly making the European Economic Area Iceland's most important free trade market. In addition to the EEA, Iceland has made 26 free trade agreements with members outside the EEA. Most of Iceland's preferential free trade agreements with partners outside the EEA are done in cooperation with the EFTA partners, Norway, Switzerland and Liechtenstein, and the relevance of these agreements for Iceland has, until now, not been studied comprehensively.

The research objectives of this thesis are to examine trade statistics of trade flows between Iceland and its non-EEA free trade partners over a period of time, before and after the entry into force of an FTA, to establish if and how Iceland's free trade agreements with partners outside the EEA have affected trade with the country in question and to draw conclusions about the actual effects of FTAs on Iceland's bilateral trade flows with its non-EEA FTA partners.

The results show that the FTAs with members outside the EEA do not seem to have increased trade flows between Iceland and the relevant partners. In several cases trade has even become less after the entry into force of an FTA, especially Iceland's exports. In some cases imports from the partner country did increase, but there is no apparent positive overall correlation in trade flows after entry into force of the FTAs examined.

The results confirm that the EEA agreement is by far Iceland's single most important free trade arrangement and that the area is the most important market for Icelandic exporters. The lack of effectiveness of the FTAs examined can have several explanations, e.g. that companies lack awareness of the benefits provided by the agreements, the homogeneity of Icelandic exports, that the EFTA cooperation constraints Iceland in certain ways in choice of partners or that historically the European markets have been by far the most important for Iceland and continue to be so, regardless of new free trade agreements. The free trade agreements examined can nonetheless provide a great platform for trade consultations, they give Icelandic companies an equal competitiveness in the relevant markets as companies from the EU and provide Icelandic companies with great opportunities in the partners' markets.

Keywords: Free Trade Agreements, EFTA, trade flows, international trade

Declaration of Research Work Integrity

This work has not previously been accepted in substance for any degree and is not being concurrently submitted in candidature of any degree. This thesis is the result of my own investigations, except where otherwise stated. Other sources are acknowledged by giving explicit references. A bibliography is appended.

By signing the present document I confirm and agree that I have read RU‟ s ethics code of conduct and fully understand the consequences of violating these rules in regards of my thesis.

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Date and place Kennitala Signature

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Abbreviations

AFTA – ASEAN Free Trade Area

ASEAN – Association of Southeast Asian Nations

BoT – Balance of Trade

CU – Customs Union

DDA – Doha Development Agenda

EC – European Community

EEA – European Economic Area

EEC – European Economic Community

EFTA – European Free Trade Association

EIF – Entry into force

EU – European Union

FDI – Foreign Direct Investment

FTA – Free Trade Agreement

GATT – General Agreement on Tariffs and Trade

GCC – Gulf Cooperation Council

GDP – Gross Domestic Product

IMF – International Monetary Fund

ISK – Icelandic Krona

ITO – International Trade Organization

JDC – Joint Declaration on Cooperation

LDC – Least Developed Countries

MFA – Ministry for Foreign Affairs

MFN – Most Favoured Nation

n/a – Not applicable

NAFTA – North American Free Trade Agreement

NATO – North Atlantic Treaty Organization

NUPI – Norwegian Institute of International Affairs

OECD – Organisation for Economic Cooperation and Development

OEEC – Organisation for European Economic Cooperation

PLO – Palestine Liberation Organization

PTA – Preferential Trade Agreement

RTA – Regional Trade Agreement

RuBeKa – Customs Union of Russia, Belarus and Kazakhstan

SACU – South African Customs Union

SPS – Sanitary and Psytosanitary (Agreement of the WTO)

TBT – Technical Barriers to Trade

TRIPS – Agreement on Trade-Related Aspects of Intellectual Property Rights

USA – United States of America

USSR – Union of Soviet Socialist Republics

WTO – World Trade Organization

WWII – Second World War

1 Introduction

There has been a significant increase in the number of Free Trade Agreements among nations in the last couple of decades and there are theories that give empirical support for the economical and statistical significance of Free Trade Agreements on members' bilateral trade. Still, there have long been doubts about the actual impact of Preferential Free Trade Agreements' on members' trade flows.

Iceland has active free trade arrangements with 64 countries. The single largest group of countries is the EU and EEA-EFTA partners through the EEA agreement, undoubtedly making the EEA agreement Iceland's most important free trade arrangement. The EU is by far Iceland's largest trading partner, accounting for almost 80% of Iceland's export of goods and 50% of its imports of goods in 2012 (Statistics Iceland, 2012). However, the EEA agreement is not a free trade agreement per se, it goes much further and gives Iceland (as well as Norway and Liechtenstein) access to EU's single market, guaranteeing free movement of goods, services capital and natural persons. Most of Iceland's free trade agreements are done in cooperation with the EFTA partners, Norway, Switzerland and Liechtenstein, who have to date made 24 free trade agreements covering 33 countries.

Iceland conducts most of its free trade negotiations through EFTA, as was stated above, and there is still to be conducted thorough research on the effects of Iceland's Preferential FTAs on the bilateral trade flows with its free trade partners (ex-post evaluation). Initial review of trade with the FTA partners suggests that trade flows are insignificant, but it is yet to be determined whether it did increase to some extent after the agreements entry into force and if perhaps takes several years for the effects of a FTA on trade flows to become evident.

The research objectives are to examine statistics of trade flows between Iceland and its free trade partners over a period of time, before and after the entry into force of an FTA, to establish if and how Iceland's free trade agreements with partners outside the EEA have affected trade with the country in question and describe the extent to which the objectives of free trade agreements have been met. Lastly, to draw conclusions about the actual effects of FTAs on Iceland's bilateral trade flows with its non-EEA FTA partners.

The first chapters examine the relevant literature; the history and development of free trade after World War II are outlined in chapter two. Some opposing views on the advantages of Preferential FTAs are examined in chapter three and Iceland's path to trade liberalization is discussed in chapter four. An overview of Iceland's international trade in goods and services is presented in chapter five and chapter six focuses on EFTA's free trade agreements, including a review on Norway and Switzerland's experience of trade flows with non-EEA FTA members. Chapters seven and eight focus on the research topic, looking at trade with free trade partners as a whole in chapter seven and finally trade flows with individual FTA partners are examined in chapter eight. Chapter nine concludes the previous chapters and results are summarised. The results are further discussed in chapter ten. Chapter 11 concludes the thesis and possible topics for future research in the field are proposed.

2 History of Free Trade

The debate on free trade has been going on for centuries. In his ground-breaking work "The Wealth of Nations" from 1776, economist Adam Smith advocated for free trade and argued that:

> *It is the maxim of every prudent master of a family, never to attempt to make at home what it will cost him more to make than to buy [and] what is prudence in the conduct of every private family, can scarce be folly in that of a great kingdom.* (pp. 456-7)

The discussion continued for decades to come, gaining attention from economists such as David Ricardo who formalized Smith's ideas in his trade model showing how two countries could gain comparative advantage from specialization in making goods and trading with each other in order to gain from their different relative efficiencies.

One of the largest catalysts in liberating world trade was the Great Depression of the 1930s. Tariff increases and the escalating protectionism were thought to have further deepened the depression. As countries faced shrinking economies, they tightened import restrictions in order to encourage local consumption. The import restrictions hurt other countries' economies since they could no longer export their products freely and in turn tightened their own import restrictions. This created a downwards spiral of increased restraints that deepened the severe depression even further. (Stiglitz, 2006)

2.1 Free Trade post WWII

In the wake of WWII, world leaders joined forces in order to try to create a more stable, united world economy and set out to establish three pillars of a new international financial system, the Bretton Woods institutions. The first two pillars, The International Monetary Fund (IMF) and the International Bank for Reconstruction Development (IBRD, later to become the World Bank) were established in 1944 and were to be further strengthened by the establishment of a trade regulating body, the International Trade Organization (ITO). While the efforts for establishment of the last-mentioned ultimately failed, the attempt sparked a discussion on non-discrimination in trade. Before the war, the British had not been too fond of the notion of implementing a low, non-discriminatory most favoured nation (MFN) tariff on all members of the trade institution and wished to keep their Commonwealth Preference tariff that extended British trade protection to its various colonies. One of those who initially opposed non-discrimination as implied by the MFN principle was John Maynard Keynes who is said to have stated on this matter:

> *My strong reaction against the word "discrimination" is the result of my feeling so passionately that our hands must be free … the word calls up and must call up … all the old lumber, most-favoured-nation clause and all the rest which was a notorious failure and made such a hash of the old world. We know also that it won't work. It is the clutch of the dead, or at least the moribund, hand.* (Quoted by Culbert, 1987, p. 387)

Americans on the other hand, wanted to revive the international efforts from before the war, strongly pushing for lower world tariffs, non-discrimination in trade and the MFN principle, claiming it was a logical follow-up after the conclusion of the war. Cordell Hull, President Roosevelt's Secretary of State 1933 to 1944, believed that free trade would lead to peace as well as prosperity. Later, both Keynes and other British economists deviated from their hold on protectionism and sided with the view that non-discrimination in trade was an essential principle in establishing a new world trade order. Negotiations proceeded for the General Agreement on Tariffs and Trade (GATT) that was to become integrated into the broader trade body, ITO. (Bhagwati, 2008)

In the end, however, it was the United States that blocked the establishment of the ITO, as the Truman administration did not foresee the bill passing through a protectionist Republican US Congress. (Mathis, 2002) But the efforts remained as the GATT had been signed in the interim and entered into force in 1948. It served as the multilateral international agreement, regulating international trade in goods until the establishment of its successor, the World Trade Organization almost fifty years later.

2.2 A Multilateral Trading System: From GATT to WTO

The cornerstone of the GATT is the multilateral non-discriminatory MFN principle, which assures all members of the GATT receive the same lowest tariff as other members. The importance of this principle is reflected in the fact that it is put forward in the very first Article of the General Agreement on Tariffs and Trade (GATT 1947) that reads:

> *With respect to customs duties and charges of any kind ... any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.* (General Agreement on Tariffs and Trade, 1947, Article I)

In other words, members may not discriminate against any good imported through their boarders based on the country of origin being a member.

Another corner principle of the GATT is the National Treatment principle (presented in Article III), which ensures foreign producers of other members the same treatment as domestic producers and are to be subject to the same rules. (Stiglitz, 2006)

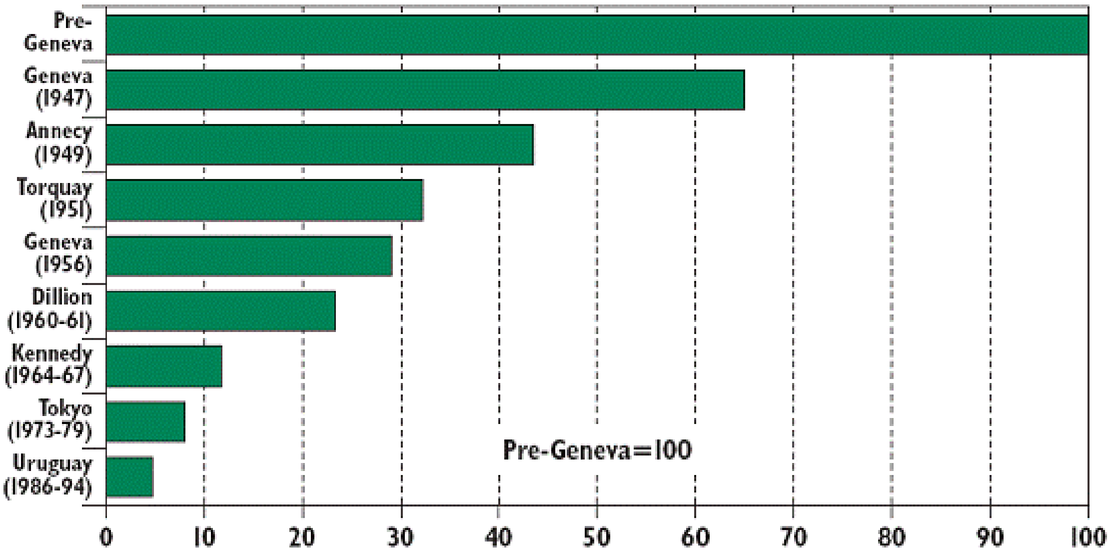
2.2.1 Multilateral Trade Negotiations

The trade negotiations within the GATT framework take place in rounds of negotiations. The first one took place in Geneva in 1947 where the 23 founding parties negotiated tariff concessions. Since then, seven more rounds have been concluded and the ninth round, the Doha round, is still underway.

The first five rounds focused on reducing tariffs on goods, and as presented in figure 1 and table 1, these concessions were quite substantial.

The sixth round, the Kennedy round in the mid sixties, was the first round to discuss non-tariff matters and generated the GATT Anti-Dumping Agreement and had a section on development. The Tokyo round brought about the first plurilateral agreements, i.e. agreements that members could choose whether or not to join. It also attempted to tackle non-tariff barriers and produced several plurilateral agreements and arrangements, some which were to become amended and turned into multilateral agreements (agreements that all members are party to) in the Uruguay round.

Figure 1: Weighted Average US Tariff Rate (Index) after GATT rounds



Source: Baghwati (1989) and Siebert (1997).

The increasing complexity of world trade and the GATT's success of drastically lowering tariffs resulted in some governments devising new means of protecting their industries from increased foreign competition. New technologies brought a completely new competition environment and it was clear that the GATT had to evolve in order to encompass the new dimensions in world trade, such as trade in services and international investment. GATT members realized that the multilateral trading system needed to be extended and strengthened. That realisation was reflected in the Uruguay round. Several of these new issues were tackled in the eighth and last GATT round, such as trade in services, intellectual property, textiles, agriculture, technical barriers to trade (TBT), sanitary and phytosanitary measures (SPS), as well as institutional changes like the establishment of a dispute settlement body to rule on trade disputes between members. The round, lasting almost eight years, was concluded in Marrakesh, Morocco on April 15, 1994, establishing the World Trade Organization. (World Trade Organization, 2013a)

The first negotiation round within the WTO was launched in Doha, Qatar in 2001. It has been officially named the Doha Development Agenda (DDA) due to its supposed fundamental aim to improve the position of developing countries in world trade. Subjects treated in the round include agriculture, services, trade related aspects of intellectual property rights (TRIPS), trade facilitation, antidumping, subsidies, rules of origin, non-tariff barriers (e.g. SPS and TBT), competition-, environment- and transparency issues. Many controversies have come up during the round, including issues on agricultural subsidies, special and differential treatment for the least developed countries (LDCs) and patented medicines. Several meetings have taken place in the round, but due to a large number of unresolved issues, negotiations have moved at glacial pace since 2008. Some progress has been made in certain areas, mainly in plurilateral agreements such as the Information Technology Agreement and Trade Facilitation Agreement. WTO's Director General, Pascal Lamy has urged members to continue work on the outstanding issues.

Some have found irony in calling this on-going round "the development round" as one of its most heated debates are the agricultural subsidies imposed by developed countries that supposedly cause enormous harm to less developed countries that largely depend on agriculture. It has been pointed out that tariffs imposed by developed countries against developing countries are, and will continue to be, far higher than those imposed to other developed countries. Some even go as far as declaring; "Doha failed". (Stiglitz, 2006, p. 81)

Table 1: Multilateral Trade Negotiations within GATT / WTO

Year	Name of round	Members	Subjects covered	Results
1947	**Geneva**	23	Tariffs	Tariff reduction affecting around $10 billion in world trade
1949	**Annecy**	13	Tariffs	5000 tariff con-cessions offered. (establishment of ITO suspended)
1951	**Torquay**	38	Tariffs	
1956	**Geneva II**	26	Tariffs	Tariff reduction of around $2.5 billion in world trade
1960-61	**Dillon**	26	Tariffs	Around 4400 tariff concessions made in-volving around $4.9 billion in world trade
1964-67	**Kennedy**	62	Tariffs Anti-dumping	50% cut in tariff levels on several products accounting for around $40 billion in world trade.
1973-79	**Tokyo**	102	Tariffs Non-tariff measures, Framework agreements	Tariff reductions of more than $300 billion in world trade.

1986-94	**Uruguay**	123	Tariffs Non-Tariff measures Services Intellectual Property Dispute Settlement Textiles Agriculture Establishment of WTO	Tariff reduction of around 40% on goods Extension of IP, patent and copyrights. Agricultural subsidies Agreement for full access of textiles from LDC and developing countries
2001 –	**Doha**	159	Tariffs Non-tariff measures Agriculture Labour standards Environment Competition Investment Transparency Patents	

Source: World Trade Organization (2013a)

2.2.2 Article XXIV

As was stated earlier, non-discrimination was the key principle on which the GATT was built, reflected in Article I of the agreement. However, a bypass from this fundamental principle was also built into the agreement, namely in Article XXIV that provides an exception to the MFN obligation for the contracting parties to create preferential trade agreements (i.e. customs unions, free-trade areas and PTAs), given certain prerequisites are fulfilled. That is, parties may enter into PTAs if they fully liberalize "substantially" all the trade amongst them without raising trade barriers to non-members of the PTA. Recalling Article XXIV: 4, that states that the purpose of a customs union or free trade area, "should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties..." and Article XXIV: 8, that defines customs unions and free trade areas as territories where duties and other restrictive regulations of commerce are eliminated "on substantially all the trade between the constituent territories ...". If the provisions of Article XXIV are fulfilled, members may eliminate barriers on internal trade and still maintain a different external tariff to non-members. Additionally Article XXIV: 5 provides parties of FTAs and CUs with permission for interim agreements to make adjustments before its ultimate objectives are fulfilled, "within a reasonable length of time" and the article also stipulates that members need to inform the WTO of FTAs and FTAs under construction. (World Trade Organization, 2013b)

This exemption from the MFN principle has led to some conflict within the GATT. It has been pointed out that the wording of the Article, especially how much "substantially all trade" is, and how much time "a reasonable period of time" is, leaves too much up for interpretation. (Mathis 2002; Tuusvuori 2000; Bhagwati 2008)

Further, the enabling clause, adopted in the Tokyo round to help the least developed countries (LDCs) to bypass the strict qualifications of Article XXIV, gave the developed and developing countries a chance to divert from the unilateral MFN treatment and allowed them to discriminate between partners based on whether they were a developed country, developing country or an LDC. Any member can use the enabling clause, bypassing Article XXIV by making a PTA with a less-developed member country for reduction or elimination of tariffs. (Bhagwati, 2008)

2.2.3 Has the era of multilateral trade liberalization come to an end?

Considering the slow pace and challenges of the Doha round, some have begun to question whether the multilateral trade negotiations are really up to date. Rose (2004) conducts a comprehensive econometric study of the effect of the multilateral trade developments after World War II, and finds that membership of the GATT / WTO did not increase its members trade or differ widely from the trade development of non-members. It strongly contests that the GATT / WTO has played a role in promoting trade as multilateralists believe. Rose (2004) finds that factors, such as short geographical distance between trading partners, belonging to a preferential trade agreement (FTAs, and Currency Unions), higher GDP per capita, common borders and a common language increases countries' trade. These factors, he concludes, control two thirds of variation in bilateral trade. When testing the variable of a countries membership in the GATT / WTO, he even reports a small negative correlation of membership on countries' trade, compared to non-members, although not statistically significant. However, the factor that actually does increase trade, he finds, is the Generalized System of Preference, which exempts WTO member countries from the MFN for the purpose of lowering tariffs for the LDCs, which almost doubles members' trade. The bottom line is that the GATT / WTO has not been successful in pushing countries to lowering their trade barriers enough, and it is suggested that members even extend their MFN tariffs to non-members, which, if true belittles one of WTO's core principles.

Others have jointed views that the multilateral regime has come to an end, e.g. economist and writer Lester Thurow who pronounced that GATT was dead at the World Economic Forum in Davos in 1988 (Quoted by Bhagwati, 2008) Alike statements have been made by Joseph Stiglitz (2006) claiming that “the era of multilateral trade liberalization seems to be nearing an end” (p. 81).

3 Preferential Trade Agreements

Bhagwati (2008, p. 116) defines Preferential Trade Agreements (PTAs) as agreements giving preferential access to certain products from certain nations by reduction of tariffs. Most PTAs in force take the form of Free Trade Agreements.

According to Krueger (1999), PTAs can be grouped into categories based on their level of market integration, Free Trade Agreements, Customs Unions, Common Markets and Economic Unions (from the least to the highest level of integration). A Free Trade Agreements (FTAs) is a preferential agreement where the parties reduce or completely eliminate tariffs between themselves, but external tariffs to non-members remain unchanged (usually at MFN level). Another form of PTAs are Customs Unions (CUs), where the parties lower or abolish tariff duties between themselves, as well as presenting a common external tariff towards non-members of the CU. When a customs union is formed between two or more parties, the average common tariff presented to non-members must not exceed the pre-union average tariff. If the accession of a member entering a CU harms trade with a non-member, compensation is to be negotiated according to Article XXIV: 6. (World Trade Organization, 2013b) A common market is a customs union that, in addition to abolishing tariffs on goods and services, allows free movement of capital and labour within its borders. Finally, the highest level of integration provided by a preferential arrangement is an economic union, which in addition to a common market, where goods, services, capital and labour flow freely, has a common economic policy.

As the word “preferential” suggests, preferential trade agreements offer favour to one over another.[1] The preferences in this context refer to the members to the agreement, making trade freer amongst them than towards non-members. Some have argued that regionalism, such as FTAs and CUs undermine the multilateral trading system (Bhagwati 1993, 2008; Bhagwati & Krueger 1995; Krishna 1998). Others find that because of successful multilateral trade liberalization, interest in further deepening trade integration with PTAs has increased. (Ethier 1998, Freund 2000) Additionally, Freund (2000) finds that when multilateral tariffs are low, trade diversion becomes less likely but the added benefits of trade creation remain. This increases the likelihood of self-sustaining preferential agreements.

[1] Oxford Online Dictionary defines the word “preference” as: [mass noun] favour shown to one person or thing over another or others.

3.1 Trade creating and trade diverting effects of PTAs

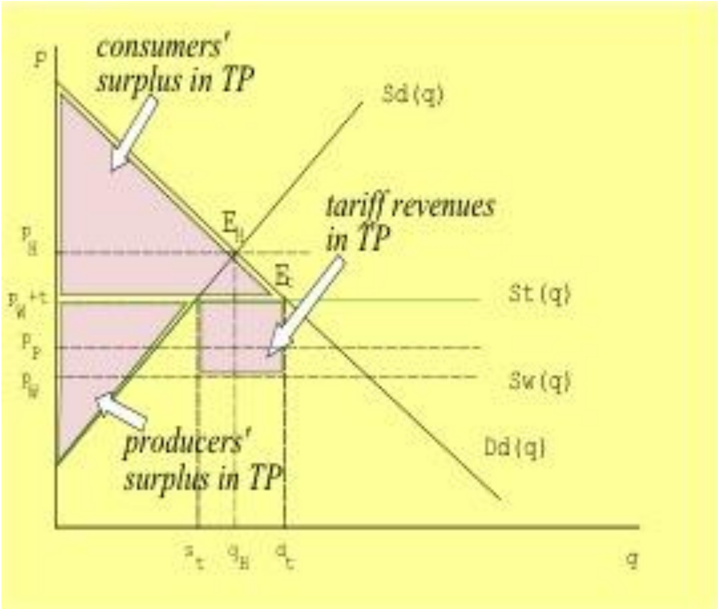
One of the earliest works discussing the welfare effects of PTAs is presented in Viner (1950). In the Custom Union Issue, Canadian economist Jacob Viner identifies how CUs can have a positive, trade creating effect on the economies of the members or how they can be trade diverting, harming both members of the CU and non-members. It studied the types of preferential arrangements of regional integration in the inter-war years in relation with the MFN principle of multilateral trade talks at the time. Trade flows were the foundation of its study and the concepts of "trade diversion" and "trade creation" were approached from that basis. In Vinerian terms, trade diversion is a switch in trade from less expensive producers, in a third country, to more expensive producers in a partner country, due to a preferential arrangement, creating a loss in terms of trade. Trade creation, on the other hand, is a switch in trade from more expensive producers to less expensive producers, or the introduction of a new product, not previously traded, leading to a gain in terms of trade. Viner's theory indicates that a CU is economically justified if it leads to trade creation but if it creates trade diversion, it is leads to decrease in efficiency and is not economically acceptable. It claims that the same effect on production and consumption can be achieved with a unilateral tariff reduction as with a CU, but with the added benefit of better terms of trade effects. Viner's concepts and work was further developed by Johnson (1965) who focused on welfare effects of customs unions and defined trade creation and trade diversion from the perspective of welfare changes posed by CUs as opposed to Viner's approach of trade flows. It looked at preferential trade agreements in terms of world allocation of resources where trade creation is beneficial to welfare, while trade diversion worsens world allocation. Johnson found that a CU is economically justified if it leads to trade creation but a CU generating a trade diversion leads to deeper protectionism and decrease of efficiency.

While Viner's work was certainly influential and has many supporters still today (Krueger, 1999, Mathis, 2002) there are those who have criticized his work e.g. for overlooking the possible gains for the consumer, not considering economies of scale and only considering static effects of a CU (Meade 1955, Gehrels 1956 and Lipsey 1957).

3.1.1 Example of trade diversion and trade creation in a Custom Union

The trade diverting or trade creating effects of a CU can be presented graphically in a simple supply and demand model, representing a market of one product (see figures 2 and 3).

Figure 2: Model of a one-commodity market before Customs Union formation



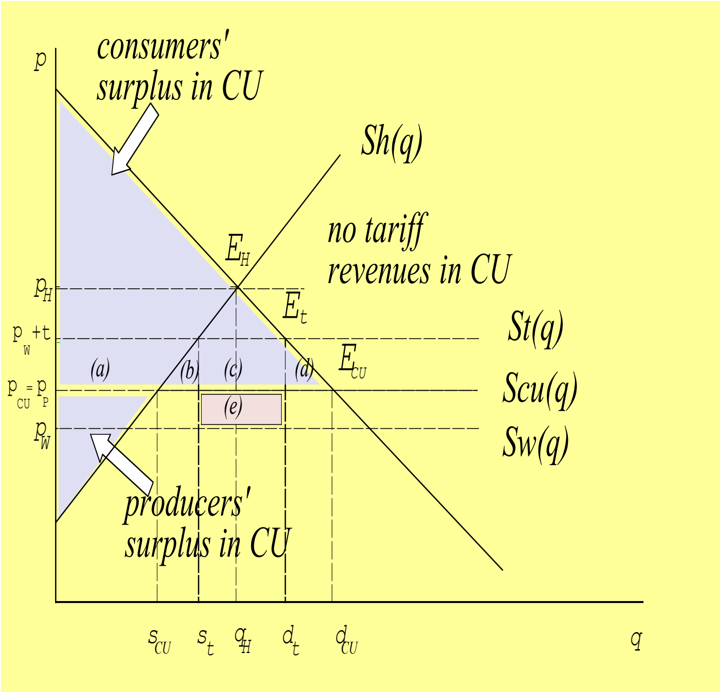
Let "H" stand for home country, "P" for the partner country and "W" for the rest of the world. The model describes a partial market for one commodity (e.g. hamburgers). The supply of hamburgers in the home market is "S_H" and the domestic demand is "D_H". Further, let "p" stand for price and "t" for the home country's MFN tariff rate. In this example it is assumed that the price of hamburgers produced in the home country (H) is higher than the ones produced in the world-market (W), even with the added MFN tariff. The price of the hamburgers produced in the potential partner country (P) is lower than the domestically produced hamburgers, but not as low as the ones produced in the rest of the world. Interpreted into an equation that is:

$$p_W < p_P < p_W{}^{+t} < p_H$$

Country H and country P enter into a customs union with each other, eliminating tariffs among them. The rest of the world still faces MFN tariffs. The vertical axis represents the price (p) and the horizontal axis the quantity (q). The equilibrium point of supply and demand is E.

Figure 3 describes the situation of H and P after entering into a CU. Since hamburgers from country P now have no tariffs, they become cheaper in country H than the hamburgers produced in W. In Vinerian terms, there has been a trade diversion because of the formation of the CU, since trade has been diverted from the more competitive W market to the less competitive P because of the preferential treatment P's hamburgers get. In Vinerian terms, the formation of the CU is trade diverting and thus economically unjustified.

Figure 3: Model of a one-commodity market after Customs Union formation



However, that approach does not capture the whole picture. While it can be maintained that the system as a whole is at some loss if the supply in the world market was perfectly elastic, and thus the producers with a competitive advantage should always advance, it does offer some gains for consumers in country H.

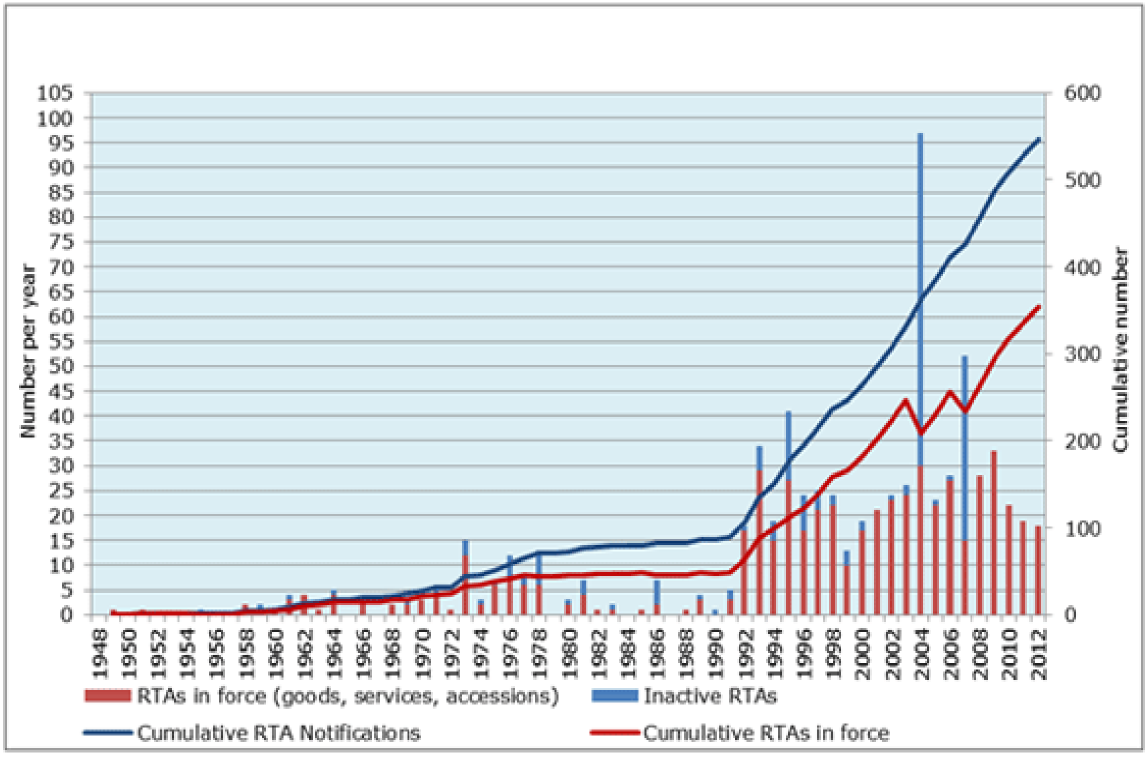
The cheaper imports of hamburgers from P reduce the supply of more expensive domestically produced hamburgers, that is, decrease in S_H. The equilibrium price decreases from E_t (tat he price of W hamburgers with tariff) to E_{CU} (at the price of P hamburgers with no tariff). The consumers in country H thus gain the amount equal to areas (a) + (b) + (c) + (d). The producers' loss of the CU is equal to area (a). Additionally the government is losing tariff revenues equal to regions (c) and (e) since they do not collect tariffs of P's products. Hence, areas (a) and (c) are not "lost" in the CU, but are simply redistributed from the producers and government to the consumers, that is, an internal redistribution.

Additionally, the trade creation of the CU consists of areas (b) and (d) and the negative trade diversion of it in area (e). Therefore, the net gain or loss can be calculated as: (a) + (b) – (e) and surmised that a negative outcome presents trade diversion but a positive outcome a trade creation. Therefore, it is impossible to make a generalization as to whether CUs are good or bad; it has to be determined on a case-by-case basis.

3.2 Proliferation of Preferential FTAs

The number of Preferential Trade Agreements has increased rapidly since the 1990's as shown in figure 4.[2] (World Trade Organization, 2013c)

Figure 4: Preferential Trade Agreements notified to the GATT / WTO 1948-2012



There are several theories on the reasons for this noticeable increase in preferential trade agreements.

It is not arbitrary to link decelerating multilateral talks with the increased activity in preferential trade arrangements. The Doha round has prolonged for over a decade without much promise of a conclusion in sight. In the interim, members resort to different ways of removing trade barriers. This link between slow multilateralism and accelerating regionalism has been widely discussed amongst academics since the early 1990s. (Krugman 1991, 1993; Bhagwati 1993, 2008 and Mansfield and Reinhardt, 2003) While there seems to be a general agreement that the two poles of international trade integration, regionalism and multilateralism, do interrelate to some extent, the theories as to how and why, are diverse. While Bhagwati (2008) is outspoken about his

[2] Note that WTO defines Customs Union and Free Trade Agreements as Regional Trade Agreements (RTAs), which this author refers to as Preferential Trade Agreements (PTAs).

convictions that regionalism poses a threat to the multilateral trading system, Mansfield and Reinhardt (2003) turn the reasoning around, arguing that recent developments in the GATT/WTO, like growing membership, sporadic negotiation rounds and growing number of trade disputes, have forced members to resort to Preferential Trade Agreements in order to gain some control within the multilateral system.

Other theories on the increased popularity of PTAs revolve around geo-political changes, e.g. the global spread of democracy. Such theories claim that the growth of democracy goes hand in hand with an increase in integrating trade arrangements, since leaders of non-democracies do not have the same incentives to enter into such arrangements as democratically elected leaders. (Mansfield, Milner, & Rosendorff, 2002)

Some suggest that individual historical events such as the collapse of the USSR and its principles started a "trend" of free trade amongst politicians who raced to sign FTAs. (Lester and Mercurio, 2009) Other, more trade related events have also been considered, e.g. when the US – Canada Free Trade talks started in 1986 or the signing of NAFTA in 1992. (Bhagwati 1991)

Bhagwati (1991) and Solis, Stallings and Katada (2009) have put forward arguments, so-called bandwagon or emulation theories, claiming because the trade giants, USA, the EU and Japan, have increasingly been signing FTAs, other nations are forced to follow suit.

Yet another theory is the domino- or contagion theory that maintains that signing or deepening one FTA can persuade third states, that previously did not have interest in signing such an agreement, to do so in order to avoid trade discrimination, making their motives for signing an FTA, defensive. (Baldwin, 1993; Baldwin & Jaimovich, 2012) In turn, more third states are "created" that make new FTAs in order to avoid discrimination and a domino-like wave of FTAs comes into being. Baldwin & Jaimovich (2012) calls the phenomena, first put forward by Baldwin (1993) who likened it to dominos, "contagion". Its hypothesis is, that the condition, i.e. the signing of an FTA between country A and B, increases the likelihood that it will spread to country C, impelling it to sign an FTA with either or both of A or B. The theory is that the domino-like spread of regionalism is driven, in large part, by defensive FTAs. Baldwin and Jaimovich (2012) claim to use broader sample of FTAs than previous studies and test the raise in number of FTAs against other variables based on some of the theories on the proliferation of FTAs that were previously discussed. Their result is, that this kind of contagion is present, and a strong positive correlation is found in their data. In their own words: “FTAs are contagious and the degree of contagion is related to the importance of the partners’ markets”. It does not find significant correlation with other theories and finally disputes the theory of slow multilateralism.

3.3 Methods for impact assessment of FTAs

There are various methods used to assess the impact of FTAs. It makes sense to assess the needs for, and possible outcomes of an FTA before negotiations are started (ex-ante evaluation). At the early stages, or even before entering into FTA negotiations, an assessment of the cost and potential benefits of the agreement, a feasibility study, often takes place. The process of bilateral trade negotiation is very complex and time consuming, even more so when the parties are more than two. The objectives of the FTA need to be clear and effective negotiation strategies determined. Involvement with public and private stakeholders may also be feasible. A pre-negotiation study based on cost-benefit analysis and economic evaluation of what the country can and cannot bring to the negotiation table should then be reflected in the overall negotiation process. Likewise is an assessment of the outcomes and impact of the FTA after it has been implemented (ex-post evaluation) important. It may show if, and how the objective of the ex-ante evaluation has been met.

There are several ways to establish the potential net worth of a proposed FTA although, as Viner (1950) and Lipsey (1957) found, the determination of such can be quite ambiguous. One of the most used Ex-Ante feasibility studies is the General Equilibrium Model that produces results about the likely welfare consequences of a proposed PTA. The model considers two countries and estimates the economic effects that an FTA will likely have. By analysing supply, demand, export and import volumes and prices in a potential partner country, an estimate on overall effects an FTA is likely to have on trade flows and general welfare can be surmised. (Plummer, Cheong, & Hamanaka, 2010)

The most common form of Ex-Post Evaluation used is the Gravity Equation or Gravity Model. It is used to explain cross-sectional variation in country pairs’ trade flows in terms of the countries’ incomes, bilateral distance and dummy variables for common languages, common land boarders and presence or absence of an FTA. (Baier

& Bergstrand, 2007) The Gravity Model is a device used to estimate the effects of a variety of variables (external and internal factors) on international trade. It can prove successful for econometrical analysis of trade liberalization as it estimates effects of distance and output is sensible, economically and statistically significant and has proven reasonably consistent across studies. It also explains most of the variation on international trade, i.e. its results seem reliable and fit the data well. (Rose, 2004)

3.4 Preferential FTAs impact on trade

There have been a number of papers assessing the impact of Preferential Free Trade Agreements on trade. Given the rapid increase in bilateral and plurilateral PTAs in the last decades, one might assume their impact on the members' trade was recognized. On the contrary, trade economists widely disagree on the matter and there is limited empirical support for the estimates of the effects of FTAs on members' trade.

One of the earliest works evaluating international trade flows in connection with FTAs was Jan Tinbergen (1962). It used the gravity equation to test several variables' effect on international trade flows, including the presence or absence of FTAs. Its results were mixed, showing limited increase (only 4-5%) in international trade flows of the members of the British Commonwealth but none at all among members of the Benelux FTA. Since then, some results have suggested the same, i.e. that FTAs have little or no effect on member's trade. Frankel, Stein and Wei (1995) and Frankel (1997) examined a wide range of FTAs, for example the EC, NAFTA, Mercosur and AFTA, and found some positive effects on members' trade flows in the cases of Mercosur, limited positive effects in the case of AFTA but none in the EC or NAFTA. Frankel (1997) even maintains that there is evidence of less trade among members of the EU in certain years in the data and claims other factors than trade liberalization contributed to increased trade within the EC. More recent research concurring with the limited effects FTAs have on liberalizing and increasing trade among members include Krishna (2012) that claims that intra-PTA trade flows account for a very small fraction or world trade, casting doubts on the efficiency of FTAs and arguing a multilateral approach remains the most relevant to world trade.

Other studies, mainly focusing on the European integration (European Economic Community and European Free Trade Association) in the 1970s and 80s, found significant positive effects on members' trade. Aitken (1973) found significant growth in gross trade creation and maintains that intra-EEC trade was almost five times higher than it would have been if the EEC had not been created, but found that the EFTA only increased members' trade by 20%. Bergstrand (1985) similarly finds that both intra-EFTA trade and intra-EEC trade increased considerably, although the results were not exactly coherent with Aitken's results, showing a higher multiplicative factor for EFTA (2) than for the EEC (1.3) Frankel, Stein and Wei (1995) also find significant effect on trade flows of EEC members in their data reaching up to 1990. Among more recent empirical findings suggesting PTAs do actually increase members' trade flows is presented in Baier and Bergstrand (2007) and Baier and Bergstrand (2009) where the long-run treatment effects of FTAs are tested. They find that previous estimates of the effects of FTAs on bilateral trade flows have been underestimated by up to 75 – 85% due to several biases and that in fact the an FTA approximately doubles members' bilateral trade flows after ten to fifteen years.

3.5 Multilateralist view on Preferential Free Trade Agreements

Multilateralists have argued that bilateral and regional trade agreements can have reverse effects that is reducing nations welfare instead of increasing it by diverting trade instead of creating new trade. Or as Bhagwati (2008) so eloquently puts it: "Acting like termites PTAs are eating away at the multilateral trading system relentlessly and progressively … the proliferating PTAs are leading us inexorably to what might be aptly described as a trade wreck." (Bhagwati, 2008, p. xii)

Multilateralists warn that preferential agreements are not to be seen as providing a simple monotonic path to multilateral free trade, cautioning that preferential agreements might create incentives within member countries against further multilateral liberalization. (Krishna, 2012)

Bhagwati (2008) suggests that regionalism is a threat to the multilateral trading system. It warns that the "pernicious development" of proliferation of regional and bilateral free trade agreements is damaging the global effort to advance free trade. It claims that PTAs are bad for smaller countries, who find themselves forced by bigger countries (i.e. the three giants EU, US and Japan) to accept terms that are not in their best interests, resulting to bandwagon- or emulation arguments mentioned in previous chapter. In that way, Bhagwati (2008) suggests, the developed countries force in the inclusion in FTAs of trade-unrelated agendas like labour and human rights, environmental standards and intellectual property enforcement. Further, it draws the metaphor that PTAs create a “Spaghetti Bowl” of discriminatory tariff rates, rules of origin and content requirement. By that the author means to describe the crisscrossing of preferences, expressed by different rules of origin and different tariff rates on the same products that has emerged with the increase of PTAs. It argues that the numerous different bilateral and multilateral Free Trade Agreements worldwide create chaos of preferences depending on where a product originates. Bhagwati (2008) completely denies the arguments that the slow pace of multilateral trade negotiations contributes to the increased popularity of PTAs and claims it the other way around, that the PTAs undercut the enthusiasm of WTO members to pursue non-discriminatory multilateral negotiations. Finally, the author admits that stopping the aggregation of PTAs now is beyond possibility and that it is also out of the question to intend to combine agreements into larger regional groups. The only realistic solution, he claims, is to reduce MFN tariffs to such a level that PTAs won’t be viable anymore. But that will require a successful round of negotiations in the WTO on tariff reductions.

Bhagwati, as some other hard line multilateralists, fails to mention or consider whether countries might find multilateral trade negotiations going hand in hand with pursuing PTAs. Such balance has been found by some of the most active members of the WTO like Chile, Australia and the USA who have parallel with strongly pursuing PTAs advocated for increased multilateral tariff reduction. In overstressing the trade diversion of PTAs it is often overlooked whether trade creation outweighs it. Additionally, it might just be that PTA proliferation is an effect of an underperforming WTO rather than a cause of the failure of the multilateral trade negotiations. In other words, PTAs might not be the parasite eating away at the multilateral system, but fugitives from a deteriorating system.

3.6 Motivations for Preferential FTAs

It has often been argued that the increase in trade preferences reflects deep frustration that countries feel with the slow pace of multilateral trade negotiations within the WTO and that PTAs provide a faster and more efficient way of liberalizing trade. (Krishna, 2012)

But certainly there could be many different reasons for countries entering into such agreements. Hur and Park (2012) identify the aspiration for economic growth as a motive for free trade negotiations. It claims trade promotions gained from the FTA lead to policy makers and economists regard FTAs as important policy tools for economic development.

A group of small countries may gain from an FTA rather than unilateral trade liberalization if outsiders have high trade barriers on them or the group faces high transport costs in exporting to outsiders. Namely, countries that are geographically close to each other but distant as a group from the rest of the world. Countries do not engage in FTAs just to reduce their own tariffs, they do it to open up access to their FTA partners' markets. If access to a partners market is more valuable than access to outsiders' (rest of the world's) markets then an FTA produces gains for its members. (Wonnacott & Wonnacott, 1981)

Melatos & Woodland (2007) looked for links between the nature of nations (similarities) and the type of trade integration that was most likely to occur among them (similar or dissimilar nations). It found that: When nations are amply similar, global free trade is most likely. When nations are dissimilar, Customs Unions are most likely. When nations are very dissimilar, FTAs are preferred.

4 Iceland’s Road to Trade Liberalisation

Iceland was not among the 23 founding members of the GATT in 1948. Nor was it among the six European nations founding the European Coal and Steel Community in 1951, which marked the first steps of the European integration. In fact, in the heyday of the newly founded republic, Iceland was hesitant to partake in multinational and regional trade liberalization. This was at odds with its enthusiasm to establish itself as an independent nation in the international community, e.g. as a founding member of NATO in 1949 and by joining the United Nations in 1946. It was not until 1968 that Iceland joined the GATT and two years later it took the step towards the European integration by joining EFTA. This initial reluctance, it has been argued, can be explained by the recently acquired and hard-earned independence from foreign dominance. (Jónsson, 2010)

Sovereignty and independence was very valuable to the Icelandic peoples and, combined with a strong sense of national identity, put them on guard against foreign influences. Another reason, explaining its hesitancy toward a closer regional integration with Europe at the time was Iceland’s close ties to the USA, formalized by the defence agreement. Iceland’s interests lay in the direction of another integration process taking place post World War II, the Atlantic integration. In addition to a defence alliance, Iceland looked to the West in terms of economic cooperation as well. (Jónsson, 2010) The USA saw Iceland as an important strategic geographic location in the escalating conflict with the USSR and thus did not pressure Iceland closer towards the European integration (Jónsson, 2001)

Another reason for Iceland’s late integration with Europe was its main (and almost only) export industry, fisheries. The small island relied on imports of industrial products, manufactured goods, fuel and various foodstuffs while over 90% of its exports were fish products. The EFTA treaty in 1960 was designed for free trade in industrial commodities, which did not benefit Icelandic exporters. Moreover, the OEEC (later to become the OECD) regarded fish as an agricultural product and since protectionism of the agricultural sector was increasing in Western Europe, rather than being liberalized, Iceland sought other trading arrangement, finding markets for its fish products in the USA and Eastern Europe. Iceland’s tense relationship over the extension of its territorial fisheries waters with its former largest importers of fish, Britain, did not help towards the European integration either.

Not until a new government was formed in 1959 that completely changed the economic management of the country, both the internal- and external policies, did Iceland start its shift towards the Western-European economic integration. The more liberal trade policy of the new government made Iceland's EFTA membership possible, given some conditions were met, the chief of which being free trade in fish and marine products. Britain, one of EFTA's founding members, strongly opposed Iceland's demands and possibility of membership was delayed. In the early 1960s, the impact of both EEC and EFTA's internal tariff reductions started to take a toll, literally speaking, on the Icelandic exporting industries, particularly the fishing industry. While intra-member tariffs were reduced on frozen fish fillets, Icelandic exporters were subject to higher external tariff rates, weakening their competitive position towards other fish exporters like Norway and Denmark in both EEC and EFTA markets. The final push towards EFTA membership came in the late 1960s when several concurrent factors, including a slump in fisheries and a fall in international fish prices, led to an economic recession in Iceland. Unemployment and current account deficit rose and several industry organizations called for Iceland's accession to EFTA. Still, there was some domestic conflict over Iceland's EFTA membership. At the time, manufacturing was a substantially large industry in Iceland and was sheltered by protective tariffs. The abolishment of such protection was bound to affect the garment- and furniture industries and its numerous workers. The right-wing government party, the Independence Party, was initially cautious towards EFTA membership, but its leader, Prime Minister Bjarni Benediktsson, believed that European integration would prove prosperous for Icelandic industries and exports. In his opening statement at the party's national assembly in 1969 Mr Benediktsson said:

> *Modern science and technology and their utilization is tied to the assumption of extensive cooperation. That is why even great nations seek to cooperate with other nations, be they large or small. If large nations need such cooperation then it is imperative to small nations … It is normal then to ask: If others, those*

who are closest to our culture and economy have such a good experience of it, why should we fear that our experience would be inferior or worse in any way?[3]

The party gradually came to accept that EFTA membership was the right way to go and the government pursued policy objective of application. Their government's two main arguments supporting membership application were:

1. To gain better market access for Icelandic exports on the EFTA market (which accounted for 40% of its exports)
2. To broaden Iceland's economic base, opening Iceland to foreign investment and develop an export-oriented manufacturing production.

Despite some local opposition, the parliament passed a motion for application of EFTA and negotiations were commenced in 1969. Negotiations were concluded within the year and Iceland became a full member of EFTA on 1 March 1970. The EFTA membership was the most extensive commitment Iceland had made as an independent country and moreover served as a bridge in further extending its European integration to the EEC with the Iceland-EEC bilateral free trade agreement in 1972.

EFTA membership had trade creating effects on the Icelandic economy. Although local manufacturing did suffer and finally went under because of supply of more productive EFTA manufacturers, in the end it proved trade creating, since membership increased efficiency and productivity in the Icelandic market. More competitive foreign goods increased the consumer's surplus, although the local producer's surplus decreased and it can be argued that artistic and technical skills were lost in the process. However, EFTA membership sustained a lot of the post 1970 economic growth by granting tariff free exports on substantially all trade within the EEC and EFTA region. (Jónsson, 2010)

4.1 Economic Effects of Iceland's EFTA Membership

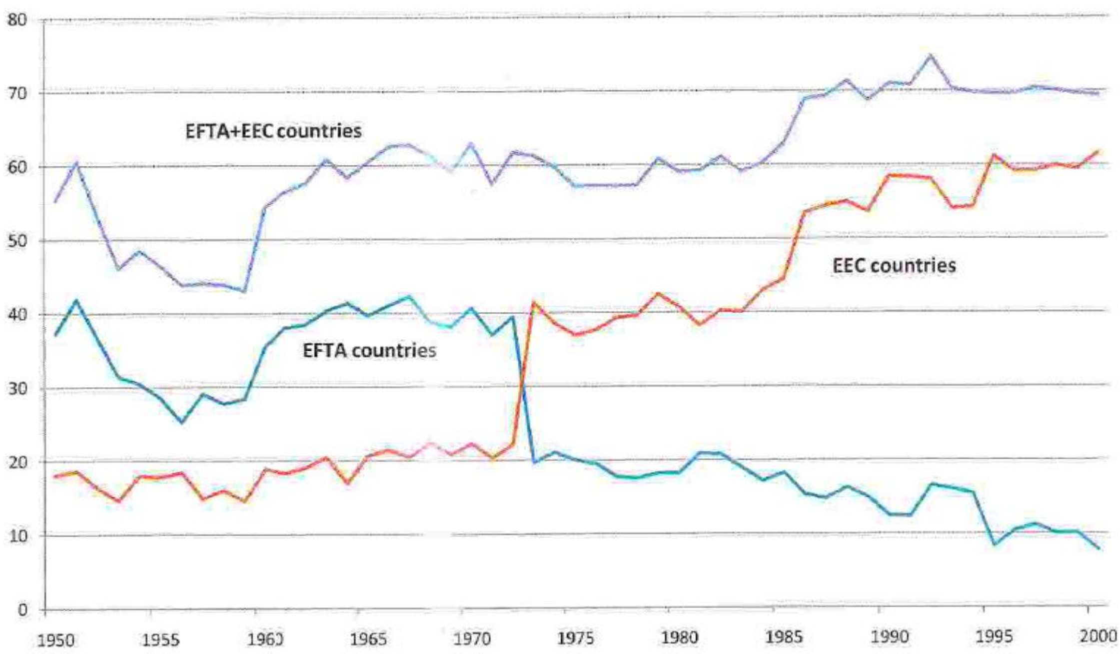
The shift towards Europe in trade and economic integration is perhaps best portrayed in trade figures from the second half of the 20th century. In the 1950s merchandise trade with the EFTA and EEC countries was around 45% of Iceland's total merchandise trade

[3] Author's unofficial translation from Icelandic. Original text red: *„Vísindi og tækni nútímans og hagnýting þeirra er bundin þeirri forsendu, að víðtækt samstarf eigi sér stað. Þess vegna leita jafnvel stórþjóðirnar samstarfs hver við aðra, jafnt stórar þjóðir sem smáar. Ef stórþjóðunum er slíkt þörf, þá er smáþjóðunum það nauðsyn … En eðlilegt er, að almenningur spyrji: Ef aðrir, þeir sem okkur eru líkastir að menningu og efnahag, hafa svo góða reynslu, hví skyldum við þá óttast, að reynsla okkar yrði önnur og lakari?"*

at the time but that portion increased to 60% in the mid 1960 where it remained for roughly two decades. A shift in proportion between the EFTA and the EEC countries occurred when Britain and Denmark left EFTA and joined the EEC in 1972 as presented in figure 5. After Iceland's accession to EFTA in 1970, imports from EFTA increased much faster than Iceland's exports to the EFTA partners, resulting in a higher trade deficit with the EFTA markets in the 1970s than in the 1960s. Some Icelandic manufacturing industries experienced a sudden increase in exports after the EFTA accession, e.g. in wool and knitted apparel and tanned skins.

Figure 5: Iceland's merchandise trade with EFTA and EEC countries 1950-2000

%



Imports from EFTA and EEC tripled in volume in fifteen years. The reduced tariff on imports from these growing trading partners resulted in increased competition, a larger product range and lower prices. On the other hand, virtually tariff free imports from EFTA and EEC made local manufacturing an uphill battle with larger, more competitive players in the market. Industries that suffered the most included production of paint and varnishes, soft drinks, sweets and furniture. However, it was not only the increased foreign competition that caused the decline in these sectors, but also volatile inflation and exchange rates, as well as economic policies favouring the fisheries industry at the cost of the manufacturing industry. (Jónsson, 2010)

If the initial goals of the EFTA policy the government used to support membership, stated above, are examined it is clear that EFTA membership did in fact both improve market access for Icelandic products, especially in frozen fish fillets, fish meal and other marine products as well as aluminium and woollen products. It did diversify exports, shifting the proportion of the exports from almost all fish and marine products to an increased share of industrial products as well as an increased investment, e.g. in the power intensive industries, aluminium and Ferro-silicon production plants that were largely financed by foreign direct investment.

5 Iceland in International Trade

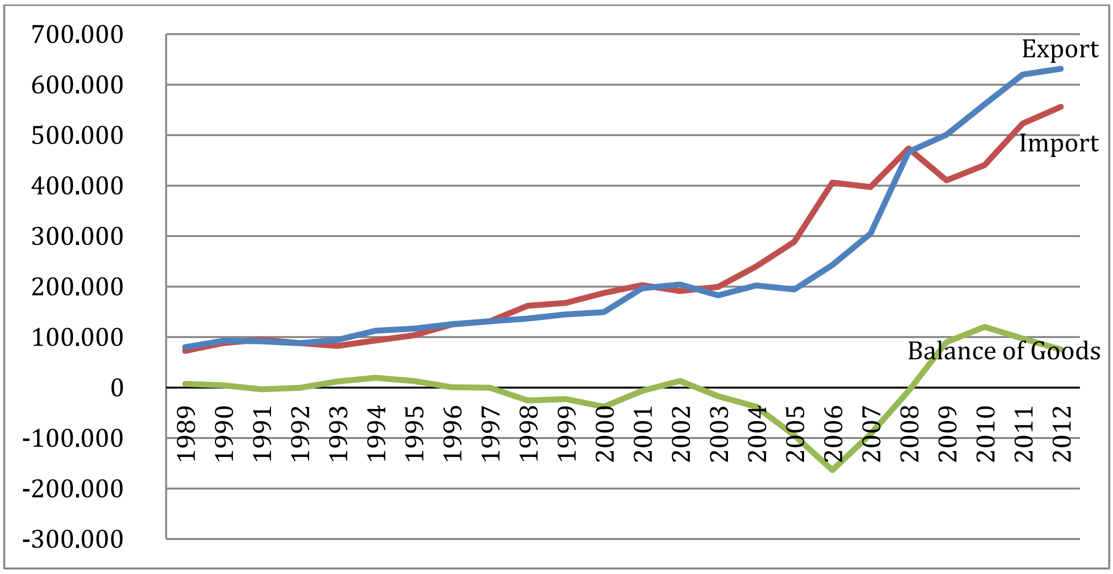
International trade is vital for a small isolated country like Iceland. Iceland depends heavily on imports from other countries, e.g. for oil and fuels, transport equipment as well as consumer goods; grains, timber, industrial goods for manufacturing, capital goods, food and beverages.

Fish and marine products were traditionally Iceland's foremost, and almost only exports. But over time the share of industrial such as aluminium products has increased at the expense of fish and marine products while exports of agricultural products have remained low, although its proportion in Iceland's exports has increased in the recent years.

Iceland has administered the policy area of international trade since it gained sovereignty from Denmark in 1918. After being administered by the prime minister and later the ministry of trade, the policy area was transferred to the ministry for foreign affairs in 1987 and a department for international trade established within the ministry for foreign affairs. (Ministry for Foreign Affairs, 2013a)

Figure 6 shows the value of Iceland's yearly exports, imports and balance of goods from 1989 – 2012 in million ISK.

Figure 6: Iceland's International Trade Flows and Balance of Goods 1989 - 2012



Source: Statistics Iceland

In 1994 Iceland took a closer step towards European integration with accession to the EEA and became a member of the single European market, granting free movement of goods, services, capital and natural persons. Access to markets outside the single market is granted by multilateral trade agreements (e.g. WTO agreements) and various bilateral trade agreements.

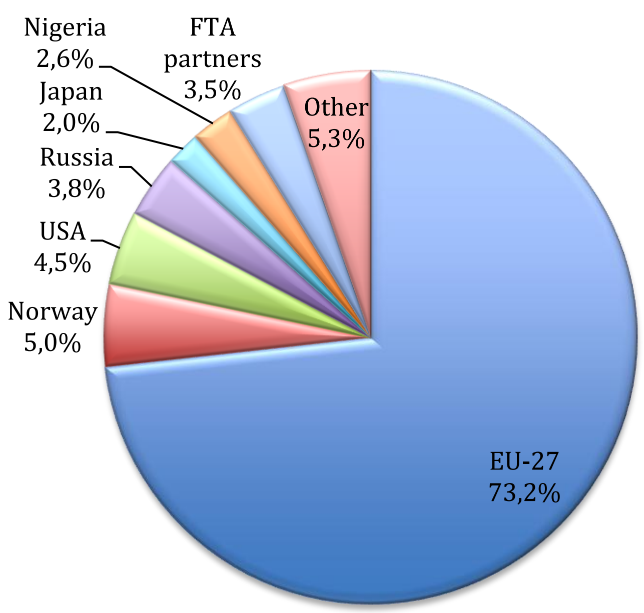
Today the EU is without a doubt Iceland's far largest trading partner, both in trade in goods and services. Other markets remain important as well as a trend towards more trade outside the common market in the recent years confirms.

5.1 Trade in Goods

5.1.1 Exports

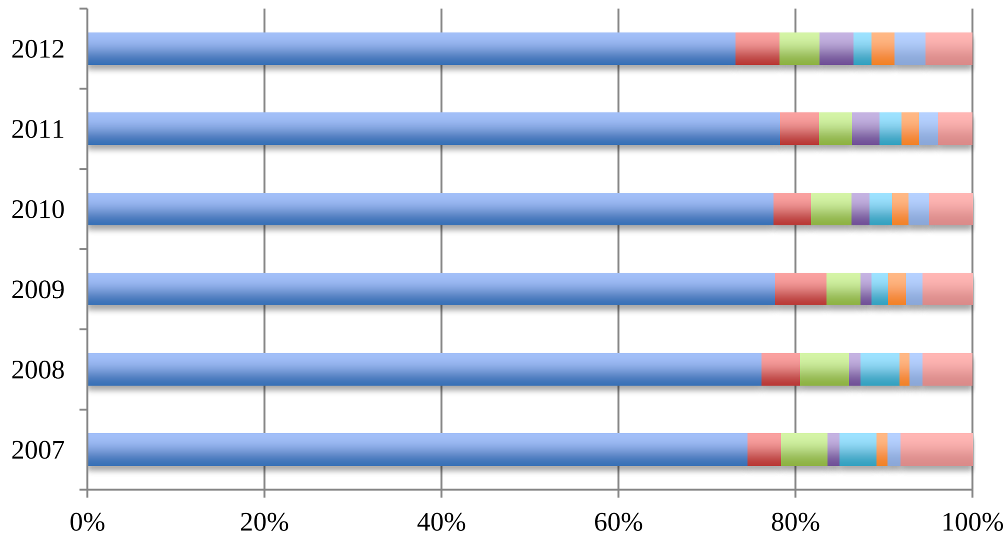
As stated above, the EU is Iceland's largest trading partner and that is especially true when it comes to exports of goods. For the last decade roughly three quarters of all exported good go to the EU-27, mainly Germany and Holland. If exports to Norway and Switzerland are included and exports to the common market are taken as a whole, almost 80% of Iceland exports of goods in 2012 are accounted for. Iceland's largest markets for exports of goods in 2012 are shown in figure 7. Markets where exports do not exceed 1% of total exports are not shown in the figure. In 2012 the remaining 20% of the export markets for Icelandic goods, excluding the EEA, were USA and Russia. Exports to the 27 non-EEA FTA partner's markets was 3,5% of the total exports or 16% of exports to countries outside the common market. Other important markets are Nigeria, who has been on the rise as an export market in the last years, and Japan, whose share has decreased somewhat recently. All in all 84% of Iceland's

Figure 7: Iceland's export of goods by markets in 2012



merchandise exports in 2012 were covered by preferential agreements (EU-27, EFTA and FTA-partners). The development of Iceland's export of goods since 2007 by markets is shown in figure 8. It is interesting to notice that while exports to the EU common market has held rather steady at or around 80%, the composition of the remaining 20% has changed slightly. The proportion of the USA as an export market for example, has become less while exports to Russia have risen respectively. Increase in exports to Russia in these last years stems largely from export of mackerel. Japan's share as an export market has dwindled while exports to Nigeria have increased in the period. Trade with the FTA partners has increased substantially from 1,5% in 2007 and 2008 to 3,5% in 2012. This trend will be further discussed in an individual chapter on trade with the FTA partners. Other markets hold less than 1% share of Iceland merchandise exports.

Figure 8: Iceland's export of goods by markets 2007-2012

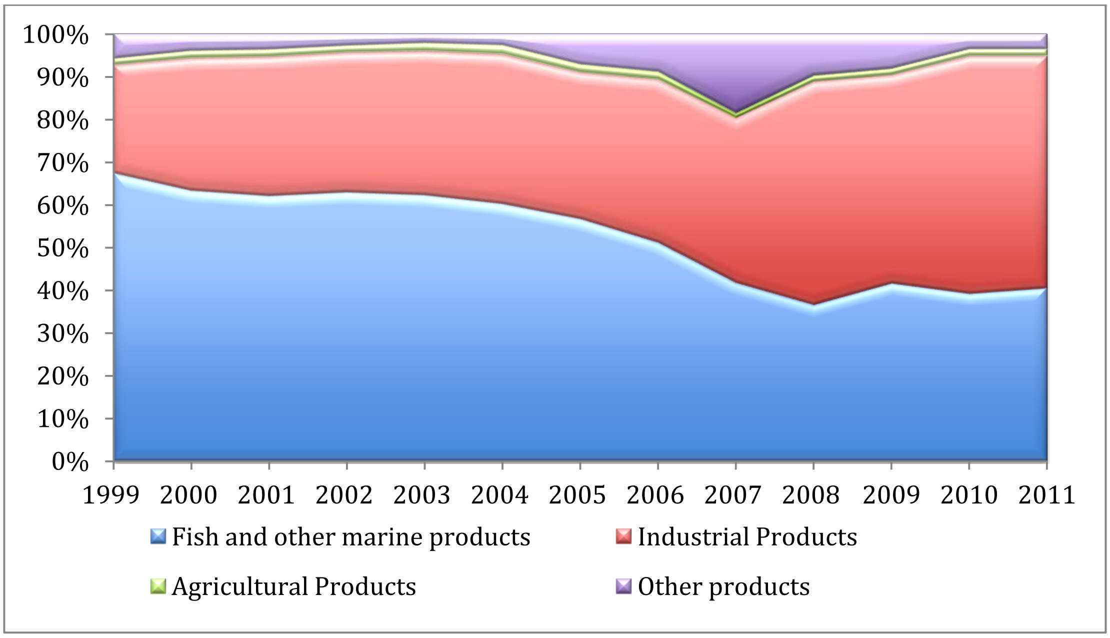


	2007	2008	2009	2010	2011	2012
EU-27	74,6%	76,2%	77,7%	77,6%	78,3%	73,2%
Norway	3,8%	4,4%	5,8%	4,2%	4,4%	5,0%
USA	5,3%	5,5%	3,9%	4,5%	3,7%	4,5%
Russia	1,4%	1,3%	1,2%	2,1%	3,1%	3,8%
Japan	4,2%	4,4%	1,9%	2,5%	2,5%	2,0%
Nigeria	1,2%	1,2%	2,0%	1,8%	2,0%	2,6%
FTA partners	1,5%	1,5%	1,9%	2,3%	2,1%	3,5%
Other	8,1%	5,6%	5,6%	4,9%	3,9%	5,3%

Source: Statistics Iceland

Another trend in trade in goods that is worth examining is the division between product sectors in Iceland's exports. Figure 9 describes the development of exports by product sectors from 1999 to 2011. The most obvious change is the shift from fish and marine products being the predominant export product sector with close to 70% of all exports to around 40% in 2011. In line with the reducing share of fish and marine products, industrial products grew from 25% of Iceland's exports in 1999 to exceeding fish and marine products with a 54% share of total exports in 2011. Agricultural products remained between 1 and 2% of total exports throughout the period examined.

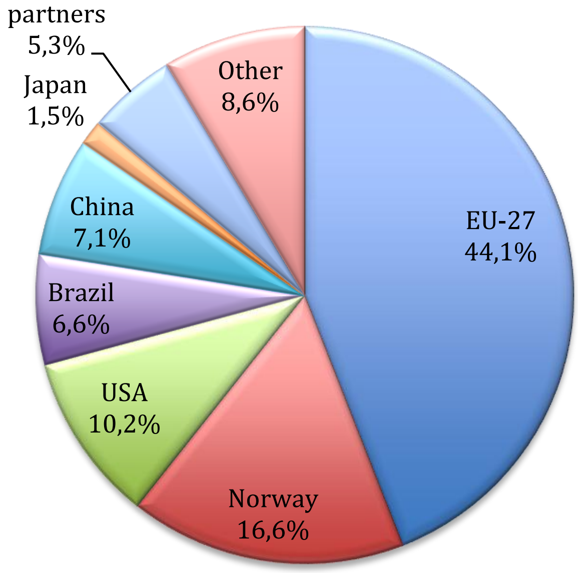
Figure 9: Iceland's export of goods by sector 1999 - 2011



Source: Statistics Iceland

5.1.2 Imports

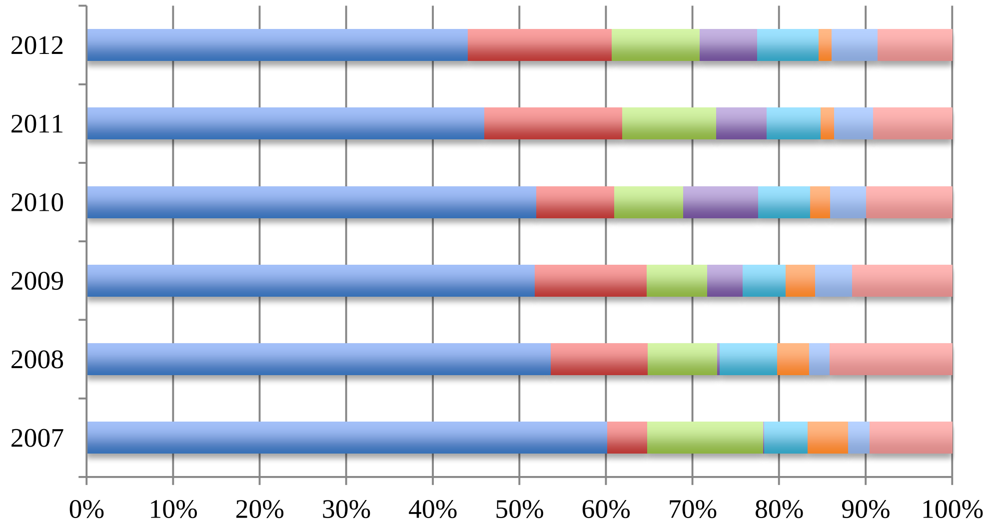
Figure 10: Iceland's import of goods by markets in 2012



Iceland's import markets for goods are more divided than its export markets. While the EU is still the largest single import market for goods, its share in imports is much less than exports. Figure 10 shows individual market's share in Iceland's import of goods in 2012. If the single market is taken as a whole, it accounts for around 60% of yearly imports of goods. The largest non-EEA import market was the USA with 10,2% share of total imports in 2012. China is the second largest non-EEA importer with 7,1% of total imports in 2012. Another growing import market is Brazil with a 6,6% share in total imports of goods in 2012. Brazil's large share caused largely by imports of alumina (HS 2818) but Brazil is the largest importer of alumina to Iceland, followed by the USA. Non-EEA FTA partners held a 5,3 % share in imported goods in 2012 and their part in total imports will be further discussed in an individual chapter. 66% of Iceland's merchandise imports in 2012 were covered by free trade agreements.

The development of each market's share in imports in the last six years is shown in figure 11. What is most noticeable, is the decreasing imports from the EU-27, from 60% in 2007 declining by a quarter in six years. The loss of imports from EU however is almost completely compensated for by the increase in imports from Norway from 4,6% in 2007 up to 16,6% of total imports in 2012. In that way, imports from the EEA as a whole only decrease by a few percentage points in the period. Imports from both China and Brazil have grown considerably in the period while Japan's share is diminishing. As the number of FTA partners grew from 15 in 2007 to 27 in 2012 it is natural that their share in trade grows as the figure shows. The largest increase occurred between 2008 and 2009 due to Canada's addition to the FTA partners in 2009.

Figure 11: Iceland's import of goods by markets 2007 - 2012

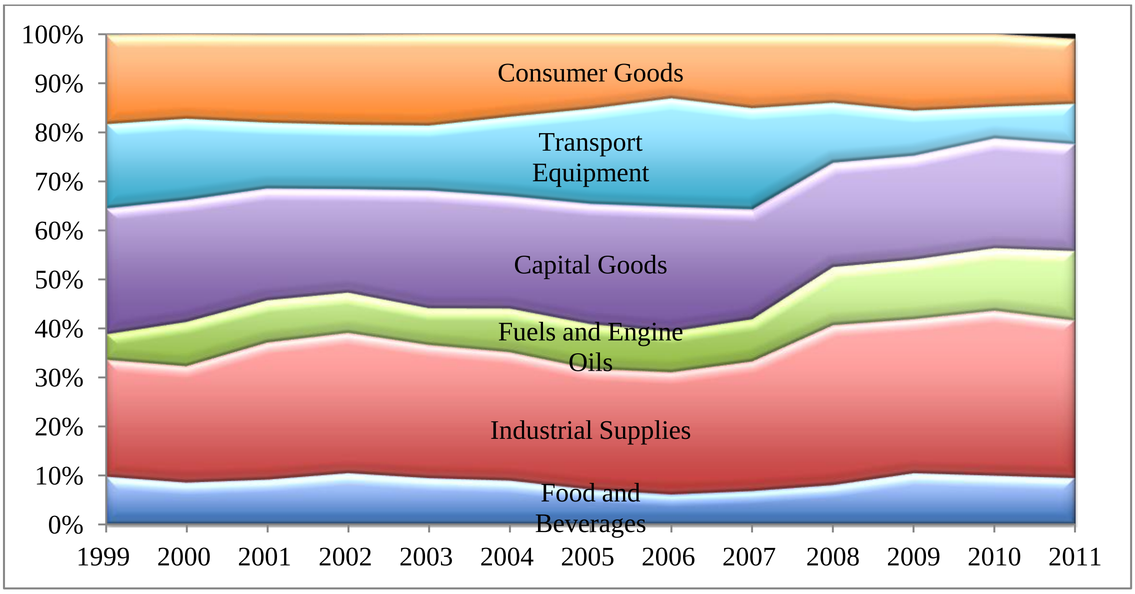


	2007	2008	2009	2010	2011	2012
EU-27	60,2%	53,6%	51,8%	52,0%	46,0%	44,1%
Norway	4,6%	11,2%	13,0%	9,1%	15,9%	16,6%
USA	13,4%	8,0%	6,9%	7,9%	10,9%	10,2%
Brazil	0,1%	0,3%	4,1%	8,7%	5,8%	6,6%
China	5,0%	6,6%	5,0%	6,0%	6,3%	7,1%
Japan	4,7%	3,7%	3,4%	2,3%	1,6%	1,5%
FTA partners	2,5%	2,4%	4,3%	4,1%	4,5%	5,3%
Other	9,5%	14,1%	11,5%	9,9%	9,1%	8,6%

Source: Statistics Iceland

If imports in goods are studied by product category, as presented in figure 12, it is apparent that the value of industrial supplies has grown the most in the twelve-year period examined. It is also the product category that grows the most, or from 23% of total imports in 1999 to 32% in 2011. Another category that has grown in value is "fuel and engine oils", but that is not surprizing given the rise in oil prices over the last decade. One product category that has decreased as a proportion of total imports in the period is transport goods, which include cars and other transport vehicles. The proportion of that category of total import values was highest in 2005–2007, or around 20% of all imports, when the sales of new cars in Iceland reached record levels. Food, drink and other consumer products have decreased somewhat as a proportion of total imports in the period.

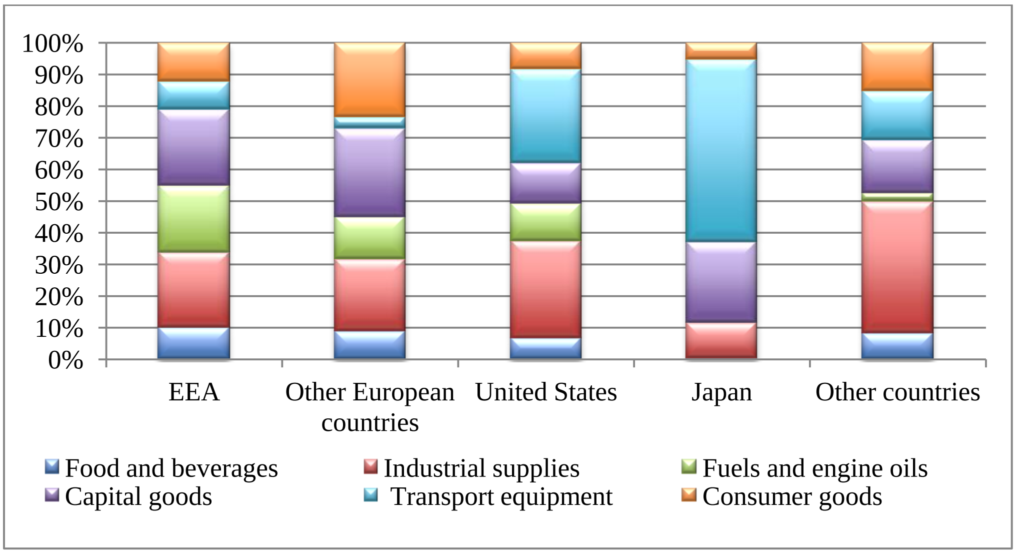
Figure 12: Iceland's import of goods by product categories 1999-2011



Source: Statistics Iceland

When the product categories are further studied by import markets, as presented in Figure 13, it is evident that the imports are different based on their market of origin. E.g. imports of capital goods, industrial supplies and fuels from the EEA in 2012 were equal with close to 25% share each and the other categories were smaller. More than half of the imports from Japan were transport equipment while the US had quite an equal share of around 30% of both transport equipment and industrial supplies. Even so, as stated above and shown in figure 10, the EEA accounts for 60% of total imports in 2012 and is the largest import market when taken as a whole.

Figure 13: Import of goods by markets and product categories in 2012



Source: Statistics Iceland

5.2 Trade in Services

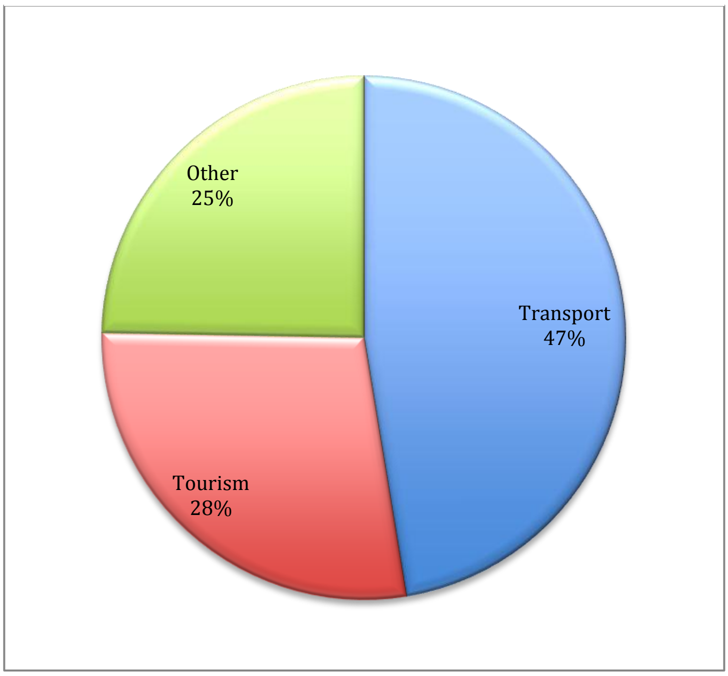
Trade in Services has been measured by statistics Iceland since 2009. Table 2 portrays Iceland's trade in services for the last four years. Both exports and imports of services have grown in value terms in the four years and exports exceed imports every year, resulting in a positive balance of goods.

Table 2: Iceland's trade in Services 2009-2012

Year	2009	2010	2011	2012
Exports	290.441	304.417	344.2689	379.134
Imports	251.728	269.634	302.670	346.982
Balance of Services	38.713	34.783	41.598	32.153

Values in million ISK

Figure 14: Iceland's Exports in Services in 2012



In 2012 Iceland exported services for a total of 380 billion ISK. The largest service subcategory in 2012 was "transportation services" with 47% share of all service export. The category includes the operations of Icelandic airlines and sea transport, for example. Tourism accounted for roughly a quarter of all service exports. A detailed division between subcategories for the year 2012 is not yet available from Statistics Iceland, and thus figure 14 shows division only between the three main subcategories of exported services in 2012.

The distribution of exported services in 2011 to individual markets is shown in figure 15, where the three largest categories, transportation services, tourism and other business services is shown and the remaining subcategories are integrated into one, as "other". 60% of total Iceland's total exports of services in 2011 went to the EU and almost 70% to the EEA. The second largest service export market in 2011 was the USA, to where services were exported for more than 42 billion ISK. Exports of services to Canada and Russia amounted for almost six billion ISK. Other countries' share was less than two billion ISK.

Figure 15: Exports in Services in 2011 by markets and subcategories

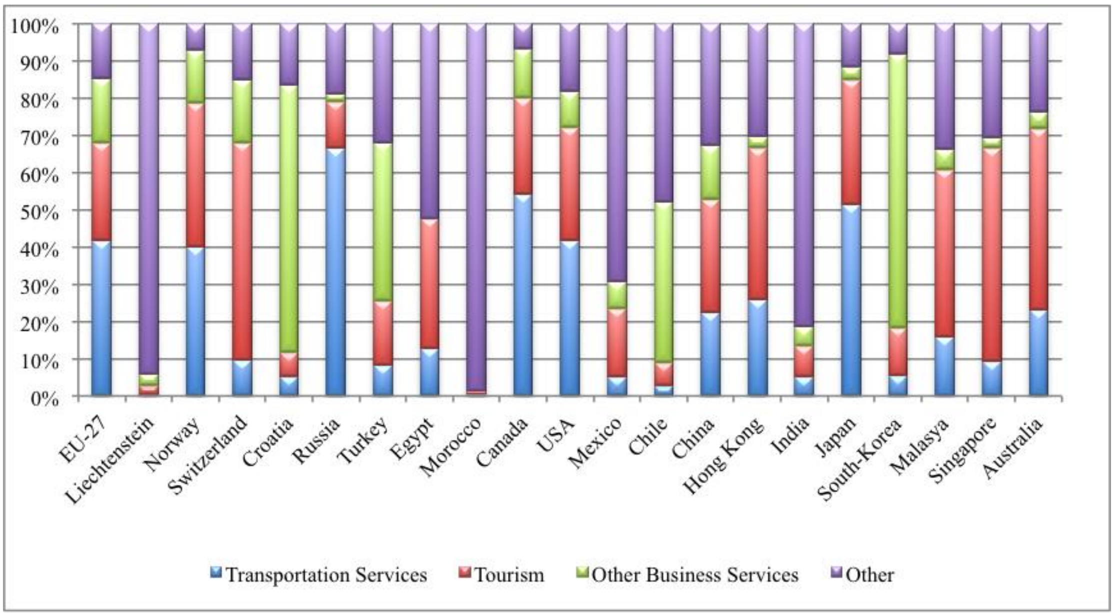
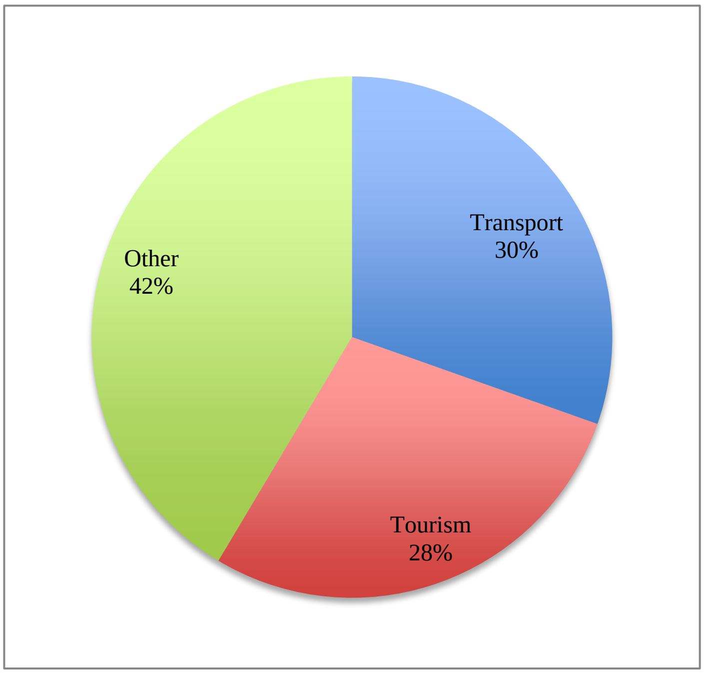


Figure 16: Iceland's Imports in Services in 2012

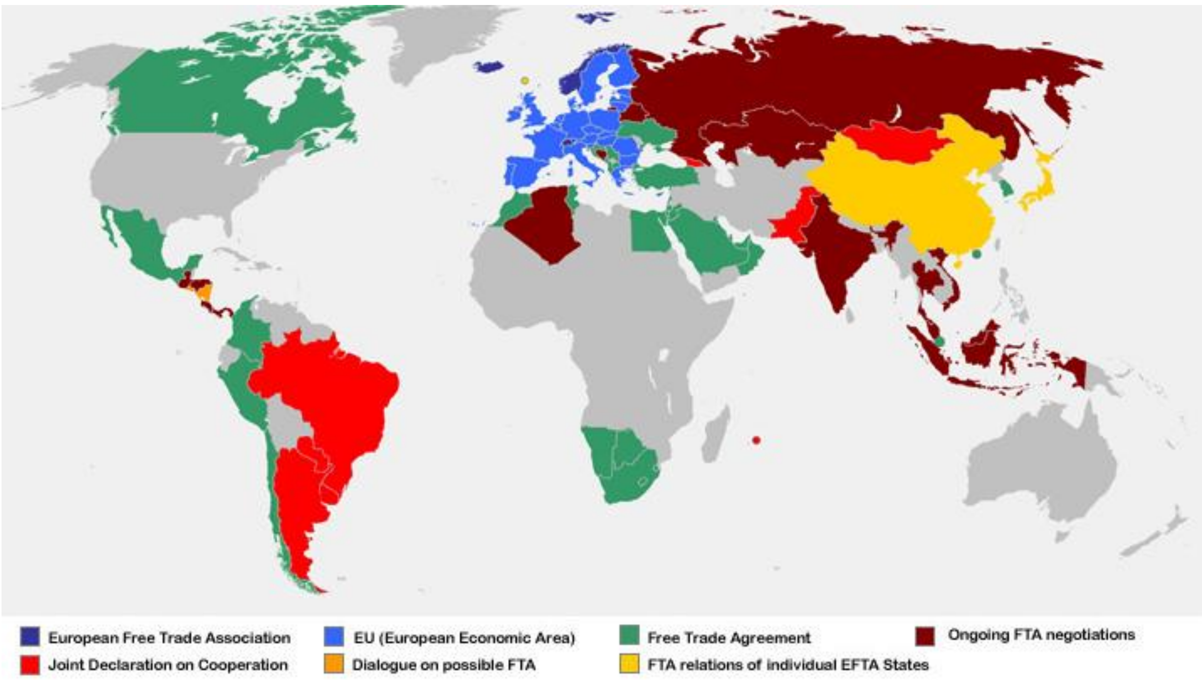


Iceland imported services for a total of 347 billion ISK in 2012, leaving balance of services positive for that year as has been in the recent years. Tourism and transportation accounted for 30% and 28% of imported services in the year, but other services for 42% as presented in figure 16. Further division for subcategories of services for 2012 is not yet available for statistics Iceland, but to better account for what the category "other" consists of, numbers from previous years indicate that the majority stems from the subcategory "other business services" (that is business services excluding communication, insurance, construction and financial services).

6 EFTA's Network of Free Trade Agreements

Today EFTA has 24 Free Trade Agreements covering 33 countries. The EFTA states are engaged in nine negotiations on FTAs with 14 different countries at the moment. In addition, Joint Declarations on Cooperation, which can be first steps towards trade relations possibly leading to negotiations and an FTA, have been concluded with five partners.

Figure 17: Map of EFTA Partners



Source: EFTA

6.1 Norway's perspective of FTAs with partners outside the EEA

A paper published by the Norwegian Institute of International Affairs (NUPI) in 2004 considered the implications and significance of EFTA's free trade agreements for Norway. As it was written in 2004, there are some things to consider, e.g. that EFTA has acquired several new partners since and also lost some partners due to the EU enlargement in 2004. But a lot of the questions posed and answered in the paper are relevant to the purpose of this thesis, to determine the effects of FTAs with partners outside EU on trade flows.

Of the topics covered in the Norwegian paper the one that is most relevant to this thesis is whether the EFTA agreements increase trade with partners outside the

EEA. It finds that increased exports were concurrent with the entry into force of the EFTA agreements. Both trade with FTA partners, possible partners (agreements in-negotiation) and partners who have signed joint declarations (often a predecessor of free trade negotiations) were considered.

The proportion of Norwegian exports to the 12 EFTA partners at the time[4], increased from 2,1% in 1993 to 3,4% in 2002. The far largest export markets of those were Singapore, accounting for 1.3%, and Turkey accounting for 1.1% of total exports in 2002. These numbers exclude oil and gas exports, but export of crude oil and natural gases to Singapore and Turkey increased as well in the period and together they accounted for the largest increase in the oil and gas exports in the period. Exports to Mexico and Israel rose by a quarter percentage from 1993 to 2002, Croatia by 0.13% and Romania by 0.12%. As the Mexico agreement did not enter into force until 2001 the initial increase was less but rose to 0.42% of total exports in 2001. At the time and for some years after, some products still faced import tariffs in Mexico due to a phasing in period.

Of the partners that EFTA was in negotiation with at the time (Canada, Egypt, South-Africa, Lebanon and Tunisia), Canada was Norway's largest export market, with a one per cent share of total exports in 2002.

Of the 14 countries that had signed Joint Declarations of Understanding vis a vis EFTA at the time, some of the partners in the Middle East were considered fairly important export markets to Norway, where as other joint declaration partners held little significance to Norwegian exports.

The overview of (then) current and possible EFTA partners outside the EU showed that EFTA was covering a great deal of important export markets for Norway. It was considered especially so in the case of Turkey, Singapore, Canada, Brazil and Ukraine. Others partners were considered less important since their share in Norway's total exports were below .01%. It was noted that their even if their significance might grow eventually, the question remained whether there was a rationale for prioritizing cooperation with those partners at that time, instead of focusing on the more promising markets. It is noted that some of the markets that had become increasingly important for Norway's exports, i.e. USA, Japan, Russia and South Korea, were not on EFTA's list of

[4] Singapore (2003), Turkey (1993), Mexico (2001), Israel (1993), Croatia (2002), Romania (1993), Chile (2004), Jordan (2002), Morocco (1999), Bulgaria (1993), Macedonia (2001) and PLO (1999)

possible partners. Those markets were identified as possible partners that EFTA should prioritize. Since then an agreement with South Korea has been signed and entered into force, and negotiations with Russia (in customs union with Kazakhstan and Belarus) are underway.

The conclusion is that with increased globalization, Norway's export partners have become more diversified and markets outside the EU are becoming increasingly important as Norway's trade with the EU decreased steadily in the 90s. However, it is considered unrealistic to assume EFTA can provide FTAs with all the new markets. Trade liberalization within the WTO is thus considered to become more important and noted that a clearer division needs to be established between EFTA and WTO. Since EFTA can only reach some of these important partners by FTAs, the rest needs to be handled within the multilateral system. EFTAs strategy in choosing partners is further criticized as it included some marginally important partners as well as leaving some very important markets out. However, it is pointed out that there are many aspects to be considered before entering into free trade negotiations, e.g. agriculture in the case of the USA and Brazil and WTO membership in relation to Russia and Ukraine, and that unless there is a clear idea of how the relevant issues might be solved, it is hardly viable to enter into negotiations with these partners.

Moreover, it is stressed that EFTA should choose partners based on their own economic interests, instead of following EUs free trade negotiations. Lastly, it is noted that while partners outside the EU are becoming more important, it is not to be seen as the EU market is no longer important as it is Norway's single most important trading partner and that market access to Europe is still far more important than any free trade agreement can provide. Increased emphasis on preferential trade agreements outside the EU should not take the focus from the EEA and market access to the EU. However, as long as Norway stands outside of the EU, it should use the possibilities and freedom that it has to open up potential markets for Norwegian exports. (Melchior, 2004)

6.2 Switzerland's perspective of FTAs with partners outside the EEA

In an economic impact assessment of FTAs with partners outside the EEA on Switzerland's trade, made for the State Secretariat for Economic Affairs, the significance of the country's network of FTA's with non-EU members on trade flows is assessed. (Abt, 2009) In addition to the EFTA agreements, Switzerland has a bilateral FTA with Japan. The Federal Council (i.e. the Swiss government) adopted implemented a criterion for the selection of prospective free trade partners in 2004. These are:

1. The current and potential economic importance of the partner country
2. The extent of existing or potential discrimination that Switzerland would suffer with its main competitors in the concerned market
3. The willingness of the partner country to enter into negotiations
4. Political considerations, i.e. the coherence with Swiss foreign policy objectives.

The Swiss foreign policy objectives are to search for markets with above average growth or a clear potential for growth. It also seeks to conduct FTAs in order to offset discrimination against Swiss products in foreign markets due to the proliferation of PTAs, not least against EU competitors (i.e. their initiatives for free trade arrangements are mainly defensive).

Abt (2009) finds that while Switzerland's world export increased on average annually 5.4% in 1998 – 2008, export to FTA partners have increased much faster or with an average growth of 10.5% per year. That result is quite noteworthy, and even more so since it is almost exactly in line with Baier and Bergstrand (2007), finding that an FTA approximately doubles member's bilateral trade after 10-15 years. In 2008 exports to FTA partners covered 6% of Switzerland's total exports.

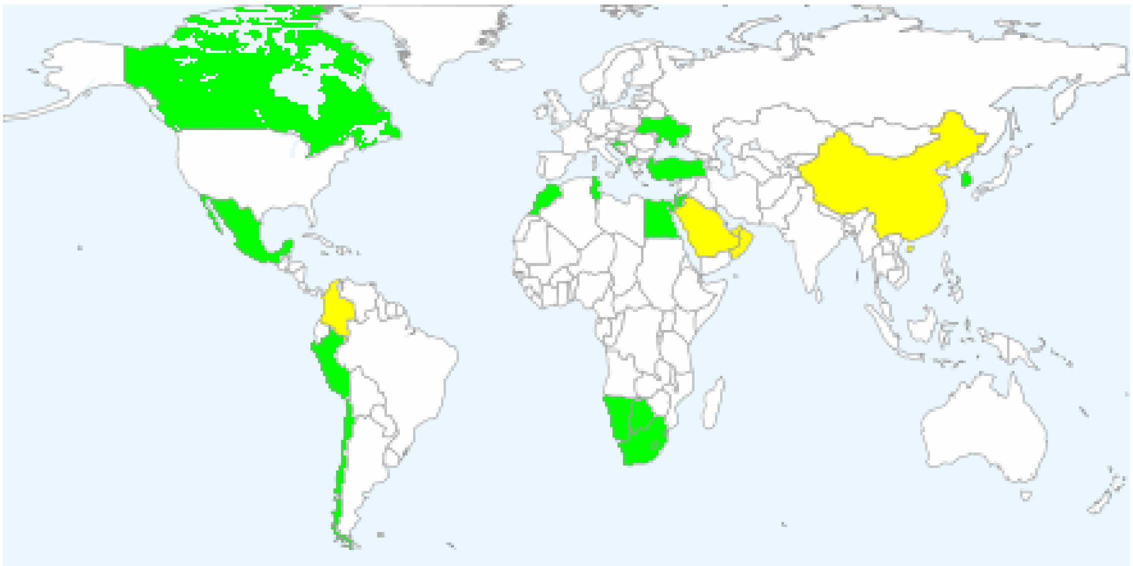
As well as finding that Switzerland's sales volumes increased considerably after entry into force of an FTA, it is noted that the share of Switzerland's top five export items (precision instruments, machinery, chemicals, pharmaceuticals and electronics) fell in almost every country after entry into force of an FTA. That suggests that the FTAs have successfully diversified the range of Swiss exports.

Abt (2009) concludes that FTAs with partners outside the EU represents, together with WTO membership and the bilateral agreements with the European Union, one of the three pillars of Switzerland's trade policy enhancing market access. It is also mentioned that Switzerland could benefit even more from both FTAs and multilateral trade negotiations if concessions could be made in the agricultural sector. However, although the benefits of FTAs have proven very important for guaranteeing Switzerland market access, multilateral trade liberalization remains the best solution. Like Melchior (2004) from the perspective of Norway, Abt (2009) emphasizes the importance of Switzerland continuing multilateral trade liberalization parallel to broadening its FTA network.

7 Iceland’s Preferential Free Trade Agreements

Currently, Iceland has 23 preferential free trade agreements in force with partners outside the EEA, covering 27 countries in five of the six inhibited continents of the world, all but Australia.

Figure 18: Map of Iceland's FTA partners outside the European Economic Area



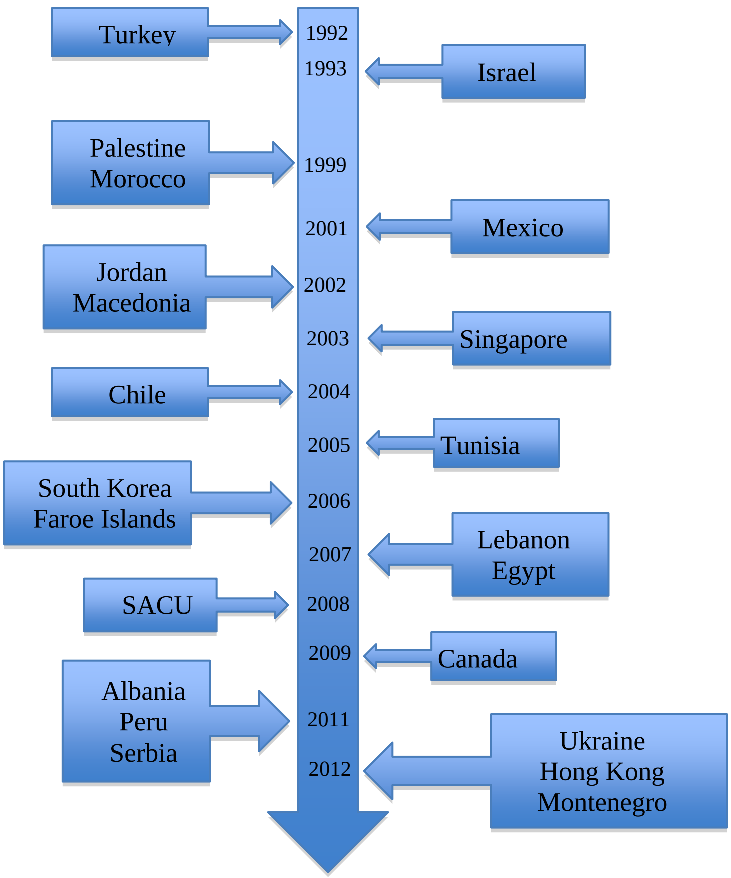
Iceland has free trade agreements in force with the following countries (in alphabetical order). Albania, Canada, Chile, Colombia, Croatia, Egypt, Faroe Islands, Hong Kong, Israel, Jordan, South Korea, Lebanon, Macedonia, Mexico, Montenegro, Morocco, Palestinian Authority, Peru, Serbia, Singapore, South African Customs Union (Botswana, Lesotho, Namibia, South Africa and Swaziland), Tunisia, Turkey and Ukraine. (Shown in green in Figure 18). All except the Hoyvik Agreement with the Faroe Islands were done in cooperation with the EFTA partners. Additionally FTAs with Colombia, the Gulf Cooperation Council (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and United Arab Emirates) and China have been signed but have not entered into force. (Shown in yellow in figure 18) The agreements with Colombia and GCC are EFTA agreements, but the agreement with China is bilateral. Iceland started bilateral negotiations with China on an FTA in 2007. The negotiations were at a stand still for a few years but were re-commenced in 2012 after an official visit of China’s Prime Minister to Iceland. (Ministry for Foreign Affairs, 2013b) The agreement was signed in Beijing on 15 April 2013 and is pending entry into force. It is the first free trade agreement China makes with a European nation, but Switzerland and Norway are also in bilateral free trade negotiations with China.

EFTA is currently in negotiations with Algeria, Bosnia and Herzegovina, the Central American States (Guatemala, Costa Rica, Honduras and Panama), India, Indonesia, Malaysia, RuBeKa (the customs union of Russia, Belarus and Kazakhstan), Thailand and Vietnam. (EFTA, 2013b)

EFTA has made Joint Declarations on Cooperation (JDC) with Georgia, Mauritius, Mercosur, Mongolia and Pakistan. The JDC's can be the first steps towards free trade negotiations between the partners. (EFTA, 2013a) Other possible future free trade partners for Iceland are USA and Japan, which have both shown reluctance towards possible free trade talks with Iceland. Especially now when it is likely that FTA negotiations will commence between USA and the EU, it is important for Iceland to secure their interests towards the USA either through EFTA or bilaterally. (Ambassador Bergdís Ellertsdóttir, personal communication, April 18, 2013) Since Switzerland already has a bilateral FTA with Japan (since 2009), any talks on free trade between Iceland and Japan would probably have to be on a bilateral level.

Figure 19 shows Iceland's active non-EEA free trade partners in a chronological order by entry into force of the agreement.

Figure 19: Timeline of Iceland's non-EEA FTA partners



7.1 Selecting Partners

Iceland has not set specific criteria for selecting its free trade partners as e.g. Switzerland has. It participates in discussion and decisions about selection of possible third-country partners with their partners in EFTA. Additionally Iceland pursues free trade negotiations with as many countries as possible in order to expand its free trade network, ideally with countries that Iceland already has considerable trade with. Since the EFTA states are only four, Iceland can despite its smallness, influence the free trade talks, both initially by selecting partners to pursue negotiations with, as well as affecting the negotiation process itself. Although some of the EFTA free trade partners may be more interesting for the larger EFTA states than for Iceland, it follows EFTA's decisions and policies as one of its four members. Many of the EFTA partners are important to Iceland as well as the larger EFTA members (Norway and Switzerland), e.g. Chile and South Korea, and Iceland's interest in pursuing free trade negotiations with those partners were upheld within EFTA. (Ambassador Bergdís Ellertsdóttir, personal communication, April 18, 2013)

EFTA established a policy towards selection of (third country) free trade partners in the 1990s when the first free trade agreements were negotiated. It followed the EU's external economic approach to form a partnership with the Mediterranean area[5] with the purpose of creating a region of peace, security and shared prosperity, formalized in the Barcelona Declaration. The Euro-Mediterranean partnership has three main fields of cooperation, political and security dialogue, social, cultural and human partnership and finally the economic and financial partnership, which includes the establishment of a free trade area between the EU and the Mediterranean, in order to create a reciprocal economic benefits for both sides. (The European Union) On 25 March 2013, the EU formally started free trade negotiations with Japan and both EU and the USA have expressed an interest in starting FTA negotiations. (Kanter and Ewing, 2013) Both Japan and the USA have until recently been reluctant to form PTAs in general.

In order to support and reinforce the single market, EFTA follows the Euro-Mediterranean partnership and has made Free Trade Agreements with several of the Mediterranean countries. Additionally, EFTA's free trade policy extends geographically

[5] The Meditarrenean area consists of Algeria, Egypt, Israel, Jordan, Lebanon, Libya, Morocco, Palestine, Syria and Tunisia.

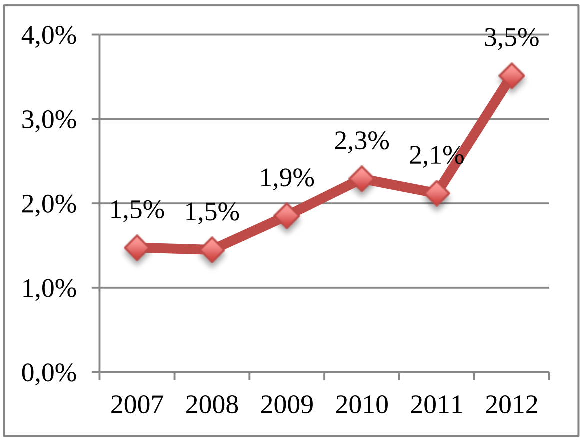
beyond the Euro-Mediterranean partnership and EFTA is working at expanding its free trade network around the world. (EFTA, 2013c)

7.2 Trade in Goods with Non-EEA FTA partners

In 2012 the value of Iceland's total trade in goods (imports and exports) was 1,23 trillion ISK (US terms, i.e. 1,23 million millions). Total trade with the no-EEA FTA partners in that year was 54,1 billion ISK or 4,4% of total trade in goods. Balance of goods account with FTA partners was negative by almost 9.700 million ISK. Even if the balance of goods with the FTA partners has been negative for the last several years, the deficit has reduced.

7.2.1 Exports

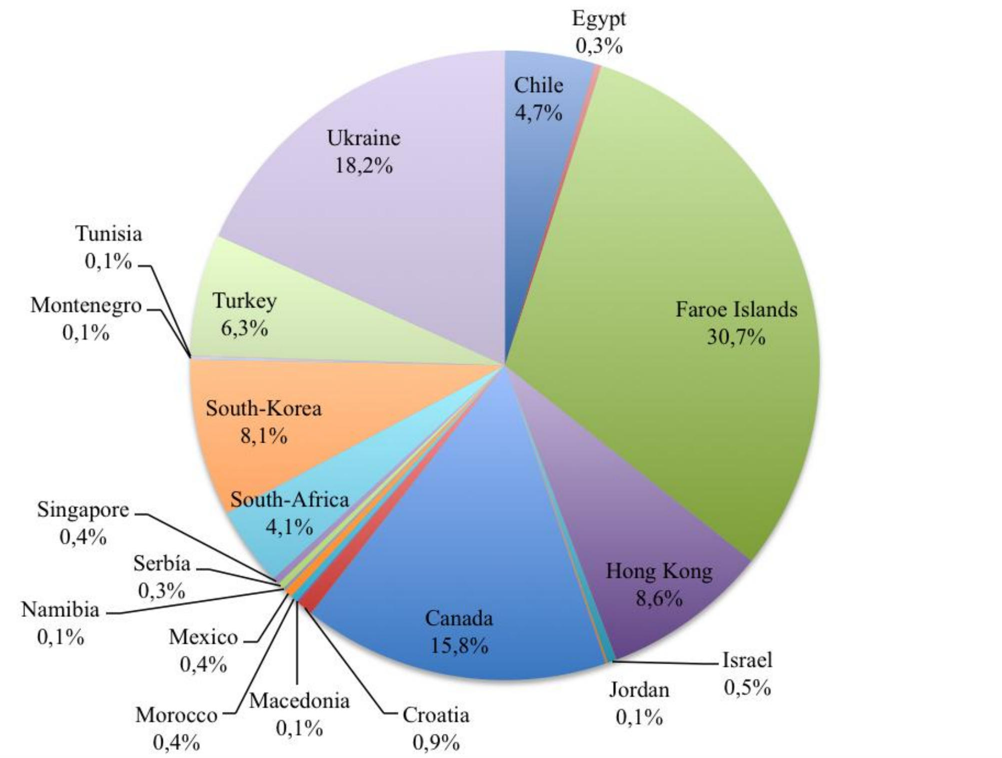
Figure 20: FTA partner's share in Iceland's total exports 2007-2012



Exports to Iceland's Non-EEA FTA partners in 2012 was 3,5% of Iceland total exports in that year, worth just over 22,200 million ISK. As a percentage of total exports, that is an increase of two thirds from the year 2011, when exports to FTA partners was 2,1% of total exports as presented in figure 20. Since 2007, the trade with FTA partners has increased by 137,8%. But it needs to be considered that in 2007 the FTA partners were 15 but had reached 27 by 2012. The addition of Canada to the FTA network in 2009 delivered a considerable increase to the category. The increase between the years 2011 and 2012 is largely due to Hong Kong and Ukraine's addition to the free trade network in 2012.

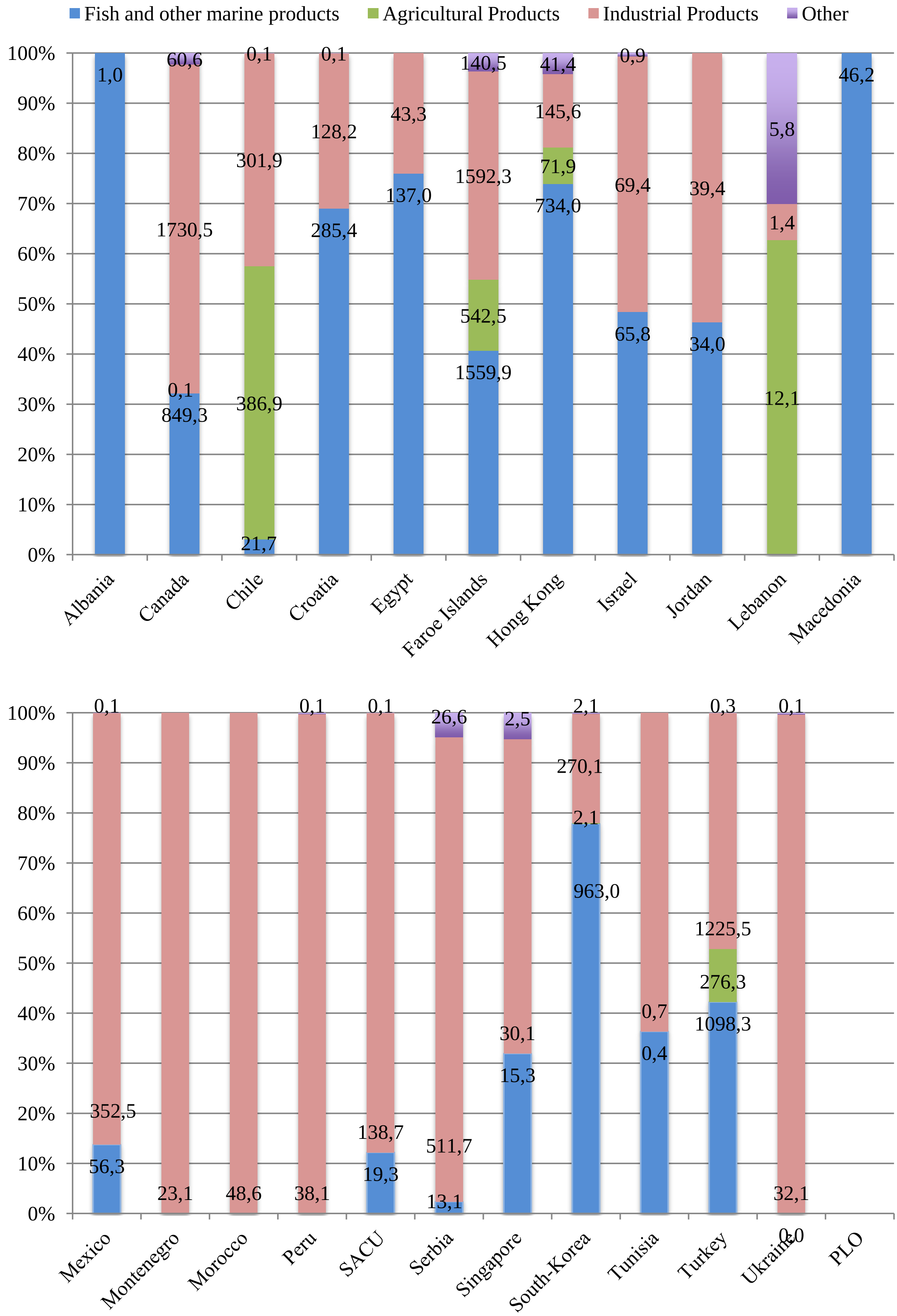
In 2012, by far the largest exporting market of the 27 was the Faroe Islands with a third of all exports to FTA partners and the only one to have more than 1% share in Iceland's total 2012 exports. Ukraine, Canada, Hong Kong and South Korea followed and together these five largest FTA partners' export markets accounted for more than 80% of exports to FTA partners in that year. Figure 21 shows how the exports were distributed between FTA partners in 2012.

Figure 21: Distribution between FTA partners in Iceland's exports in 2012



To better understand the extent of Iceland's exports to the FTA partners it can be useful to look further into the categories of exports. The most recent export figures by product categories and individual markets are from 2011. When exports by product categories to individual FTA partners are compared to Iceland's total exports by categories (in figure 22) it is evident that the exports to the FTA partners is sometimes quite different in combination than Iceland's typical exports that for 2011 which were 54% industrial products, 40% fish and marine products, 4% agricultural products and 2% in other products (as discussed in an earlier section).

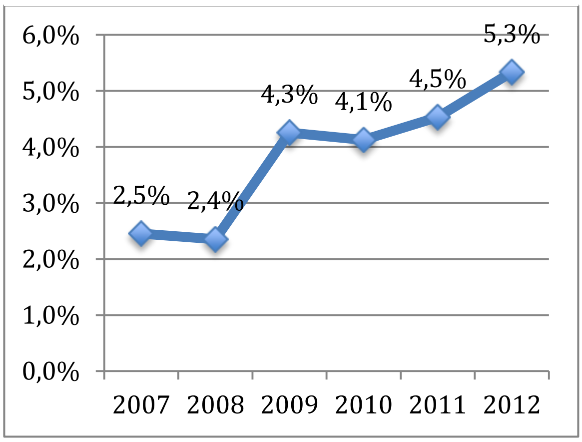
Figure 22: Iceland's 2011 exports to FTA partners by product categories



Values in million ISK

7.2.2 Imports

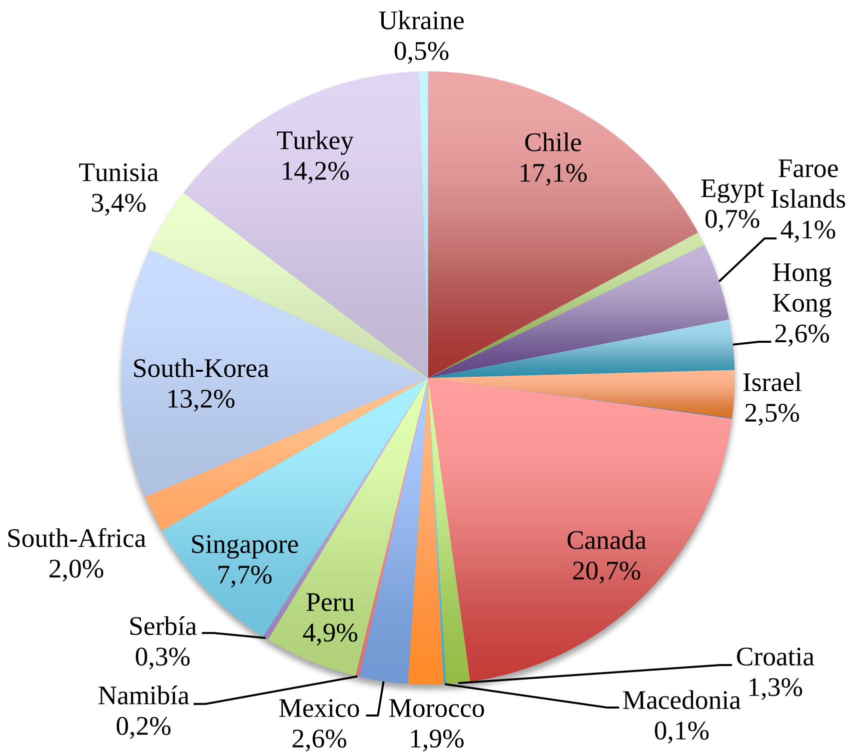
Figure 23: FTA partner's share in Iceland's total imports 2007-2012



In 2012 imports from Iceland's Non-EEA FTA partners was worth 31.900 million ISK or 5,3% of total imports. The largest increase in imports from FTA partners came with Canada's addition to the group in 2009, which almost doubled the share in imports from FTA partners between years as seen in figure 23. The increase between the years 2011 and 2012 is in large part due to Hong Kong's addition to the group of FTA partners in 2012.

Of the FTA partners, Canada was the largest importer accounting for roughly 20%, (and the only FTA partner who had more than 1% share in Iceland's total imports) followed by Chile, Turkey, South Korea and Singapore. These five largest importing FTA partners account for almost three quarters of the total FTA partner's imports. The individual country's share in imports from FTA partners in 2012 is demonstrated in figure 24.

Figure 24: Distribution between FTA partners Iceland's imports in 2012



8 Trade with individual FTA partners

It has been established that as a proportion of Iceland's total external trade, trade with FTA partners is rather small. Even so, it is yet to be determined if the preferential FTAs do affect Iceland's trade flows vis-a-vis individual FTA partners. In order to do so, each FTA must be studied separately and trade with the partner in question examined before and after the entry into force of the agreement. Here, the four years before the FTA's entry into force is considered, but in order to evaluate the long-term effects of the FTA (as was done in Baier and Bergstrand, 2007), trade statistics up until 2012 are examined.[6] In order to avoid irregularities due to exchange rate fluctuations, inflation and difference between years in total world imports and exports, most trade figures will be presented as a percentage of Iceland's total trade. An exception of that is where trade with the relevant partner does not reach 0,01% of total trade, and then figures are presented in million ISK. Figures that are presented in value terms are in nominal prices ISK (non-inflation adjusted). All trade statistics are from Statistics Iceland, unless another source is stated. The agreements are studied by their date of entry into force, as presented in figure 19. Information on the individual FTA's was retrieved from the English version of the FTAs provided on EFTA's homepage. (EFTA, 2013c)

8.1 Reliability of data from Statistics Iceland

A possible limitation of this research method is the reliability of the data provided by Statistics Iceland. Each exporter and importer is responsible for filling out customs declarations themselves for import or export of goods. And while it can be assumed that most external trade can be recorded through customs declarations, they also pose a risk of registration errors, e.g. wrong custom tariff numbers, incorrect value or quantity, errors in exchange rate calculations, or that final destination or country of origin of the product is incorrect. Additionally a certain time-lag can be created as the customs declarations are not necessarily filled out at exactly the time of export or import and thus a part of the data may not relate to the months when the actual export or import took place. Statistics Iceland claims that it tests the data in order to increase its reliability, but it is not possible to review all records and therefore some errors might be present. (Statistics Iceland, 2011) This error is for example clearly reflected in large trade flows with Holland, which serves as a common transit point for shipments for farther destinations. The risk of this kind of error grows as the geographical distance of

[6] As of April 2013 Statistics Iceland still presented figures for the year 2012 as "estimatesed numbers"

the final destination increases, since it is likely that the consignment will transit through at least one other country before reaching its end destination. Import of goods to Iceland, originating in far off countries (e.g. in Asia or South-America), shipped through other countries, may have the hub-country registered as the point of origin instead of the actual country of origin. Likewise Icelandic exports to distant countries, will likely transit though one or several destinations in Europe or the USA, and some of these exports may be registered as exports to the transit country instead of the final destination, skewing the trade statistics. While this error is present in the trade figures, Statistics Iceland provides the only source available for Icelandic international trade flows.

8.2 Turkey

Official Name: Free Trade Agreement Between the EFTA States and Turkey

Scope: Trade in Goods

Entry into force: 1 April 1992

The free trade agreement between the EFTA states and Turkey was the first of EFTAs network of FTAs. It covers trade in industrial products, fish and marine products and processed agricultural products. Additionally a bilateral agricultural agreement between Iceland and Turkey was concluded and entered into force on the same date as the FTA. In addition to trade in goods, there are articles covering government procurement, intellectual property, competition and state aid that are in accordance with the provisions under the WTO but somewhat go beyond what is stipulated there.

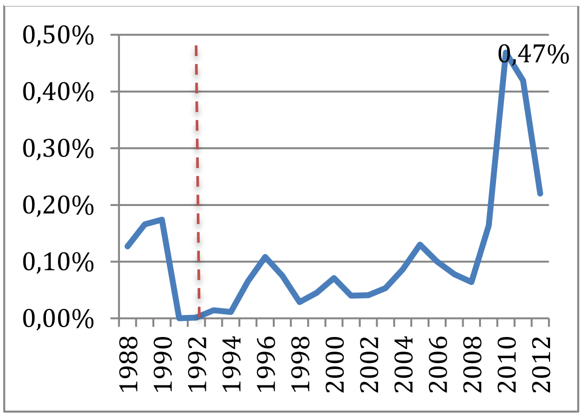
Iceland and Turkey's trade in goods did not change extensively in value terms after the entry into force of the FTA in 1992. In fact, value of the countries' total trade three years after its entry into force (1995) was similar to that of three years before its entry into force (1989), but that is in large part due to a slump in exports in 1991 and 1992 which contributed to a considerable decrease in total trade in goods the two years leading up to the FTAs entry into force. After 1992 value of trade in goods have risen steadily, but imports a great deal more than exports, causing a negative balance of trade excluding one year (2010) in the two decades the FTA has been in force.

Table 3: Trade in goods with Turkey 1988-2012

Year	Total trade	% change	BoT	Year (cont.)	Total trade	% change	BoT
1988	118	NA	39	**2001**	780	*18%*	-623
1989	200	*70%*	65	**2002**	899	*15%*	-732
1990	244	*22%*	78	**2003**	1.775	*97%*	-1.580
1991	115	*-53%*	-115	**2004**	1.853	*4%*	-1.504
1992	88	*-24%*	-85	**2005**	2.896	*56%*	-2.391
1993	95	*8%*	-68	**2006**	3.427	*18%*	-2.940
1994	111	*17%*	-86	**2007**	2.517	*-27%*	-2.043
1995	205	*85%*	-53	**2008**	2.726	*8%*	-2.129
1996	343	*67%*	-70	**2009**	3.186	*17%*	-1.548
1997	316	*-8%*	-119	**2010**	5.064	*59%*	194
1998	353	*12%*	-274	**2011**	5.504	*9%*	-303
1999	409	*16%*	-279	**2012**	5.925	*8%*	-3.144
2000	661	*61%*	-449				

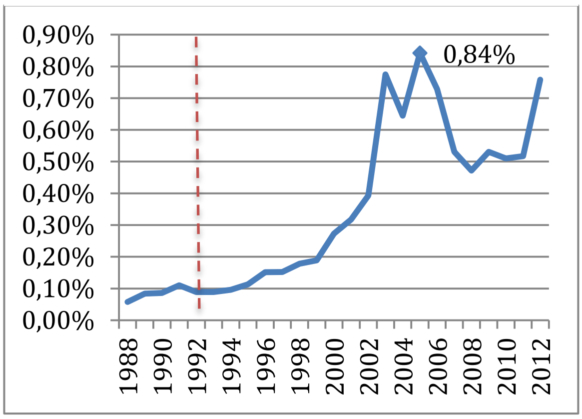
Values in million ISK

Figure 25: Exports to Turkey as a percentage of total exports 1988-2012



Exports to Turkey, as a proportion on Iceland's total exports, has never exceeded 0,5 per cent in the two decades the FTA has been in force. The average percentage of exports to Turkey in the period (1988 – 2012) is 0.11%. Exports to Turkey were slim to none in the two years leading up to the FTAs entry into force in 1992, but increased afterwards, both in value terms and as a percentage of total exports. As presented in Figure 25, the exports to Turkey rose to 0,47% of total exports in 2010, but that increase is predominantly based on a registered export of an airplane in that year. Iceland's main exports to Turkey are seafood (mainly coalfish), industrial products such as ferrosilicon and measuring devices. Additionally exports of agricultural products, mostly lamb and mutton, have increased in recent years.

Figure 26: Imports from Turkey as a percentage of total imports 1988-2012



Imports from Turkey are a much larger proportion of Iceland's total imports than the exports. After the entry into force of the FTA in 1992, imports from Turkey increased as a proportion of total imports. Since 2000 imports from Turkey have multiplied and reached a 0.84% of Iceland's total imports in 2005. The main import products are clothing, transport equipment and raw materials for industrial manufacturing.

Trade with Turkey increased steadily after the entry into force of the FTA in 1992, imports more so than exports. Total trade in 2012 was worth almost 6 billion ISK, which were 0,5 of total trade in goods in that year.

8.3 Israel

Official Name: Free Trade Agreement Between the EFTA States and Israel

Scope: Trade in Goods

Entry into force: 1 January 1993

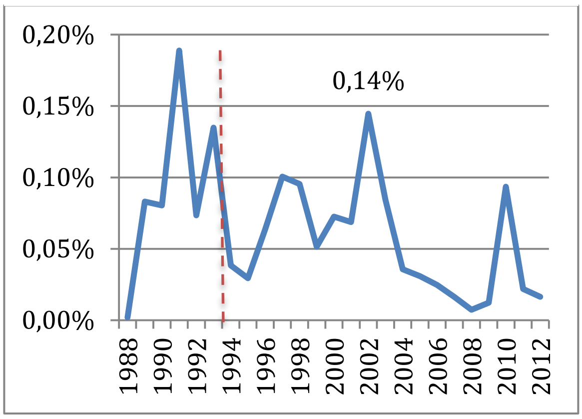
The free trade agreement between the EFTA states and Israel covers trade in industrial products and fish products. The Agreement also includes provisions on competition, intellectual property rights, government procurement, and state aid, which go further than provided by those commitments under the WTO. A bilateral agricultural agreement between Iceland and Israel was made alongside the FTA. Since the EFTA-Israel Agreement is one of EFTA's oldest existing FTA and both sides have extended their free trade network since then, the members have considered updating and modernising it, especially in the areas of intellectual property rights, rules of origin and trade in processed agricultural products.

Table 4: Trade in goods with Israel 1989–2012

Year	Total trade	%change	BoT	Year (cont.)	Total trade	%change	BoT
1989	209,0	*531%*	-76,0	**2001**	499,2	*-2%*	-229,0
1990	125,0	*-40%*	24,0	**2002**	751,1	*50%*	-160,1
1991	263,7	*111%*	82,1	**2003**	563,4	*-25%*	-255,4
1992	425,9	*62%*	-296,9	**2004**	569,9	*1%*	-425,3
1993	188,3	*-56%*	67,1	**2005**	621,4	*9%*	-501,4
1994	122,1	*-35%*	-35,7	**2006**	570,4	*-8%*	-450,2
1995	89,7	*-27%*	-21,1	**2007**	612,5	*7%*	-512,7
1996	182,5	*103%*	-21,7	**2008**	727,9	*19%*	-659,9
1997	262,4	*44%*	1,4	**2009**	794,1	*9%*	-670,9
1998	341,7	*30%*	-80,9	**2010**	1356,5	*71%*	-307,3
1999	316,9	*-7%*	-167,7	**2011**	1156,8	*-15%*	-884,6
2000	508,9	*61%*	-292,3	**2012**	901,0	*-22%*	-693,6

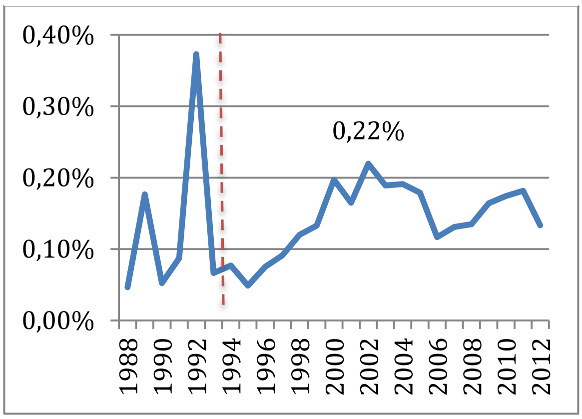
Values in million ISK

Figure 27: Exports to Israel as a percentage of total exports in 1988 – 2012



Exports to Israel, as a proportion of Iceland's total exports has not exceeded 0,14% since the entry into force of the agreement. The average exports to Israel in the period 1988–2012 are 0,07% of total exports. Two years before the entry into force of the agreement, in 1991, exports to Israel reached as much as 0,19% but declined in the years just after the entry into force. Main exports to Israel is fish and marine products, mainly coalfish, and medical equipment. The development of exports to Israel as a proportion of total export is shown in figure 27.

Figure 28: Imports from Israel as a percenaget of total imports in 1988 - 2012



Imports from Israel are a much larger proportion of Iceland's total imports than the exports. After the entry into force of the FTA in 1993, imports from Israel increased as a proportion of total imports and reached 0,22% of total imports in 2002 but were on average 0,14% of total imports in the period 1988-2012. The main import products are fruit and fresh herbs, inorganic chemicals and iron for industrial production. Figure 28 shows the development of imports from Israel before and after the entry into force of the agreement in 1993.

8.4 Palestine

Official name: Interim Agreement between the EFTA States and the PLO for the Benefit of the Palestinian Authority

Entry into force: 1 July 1999

Scope: Trade in goods

The agreement covers trade in industrial products and fish and marine products. It also includes provisions on rules of competition, protection of intellectual property, public procurement, state monopolies, state aid and payments and transfers.

According to statistics Iceland, no trade has been between Iceland and Palestine in the last decades, neither before nor after the entry into force of the FTA. There has been a discussion, e.g. in the Icelandic parliament, that there is a possibility that some products originating in Palestine may be sold as Israeli products. By an example from Britain and Denmark, a parliamentary resolution was put forward in 2012 aiming at implementing rules on labelling of products originating from Palestine settling lands and making Palestine better able to utilise the FTA. The resolution has passed through the parliamentary committee but has yet to be enforced. (Alþingi, 2013)

The free trade agreement with Palestine is special in the sense that it is the only EFTA FTA with a country that is not a member of the WTO, but the Palestinian Authority has applied for observer status to the organization.

8.5 Morocco

Official name: Free Trade Agreement Between the EFTA States and the Kingdom of Morocco

Entry into Force: 1 December 1999

Scope: Trade in goods

The Free Trade Agreement with Morocco was signed in 1997 and entered into force two years later. The EFTA states eliminated tariffs on goods upon entry into force, but Morocco had a 12-year adjustment period to eliminate tariffs in steps. The transitional period ended in 2011. The agreement covers trade in goods, i.e. processed agricultural products, fish and marine products. Additionally it includes provisions on rules of origin, protection of intellectual property rights, public procurement, competition, state aid and payments and transfers. Special provisions in the agreement allow Morocco to introduce temporary measures to protect infant industries and sectors going through changes or difficulties. Since the entry into force of the agreement, amendments have been made in the area of rules of origin. The partners have discussed the possibility of extending the agreement to cover trade in services as well. In addition to the FTA, Iceland made a bilateral agricultural agreement with Morocco.

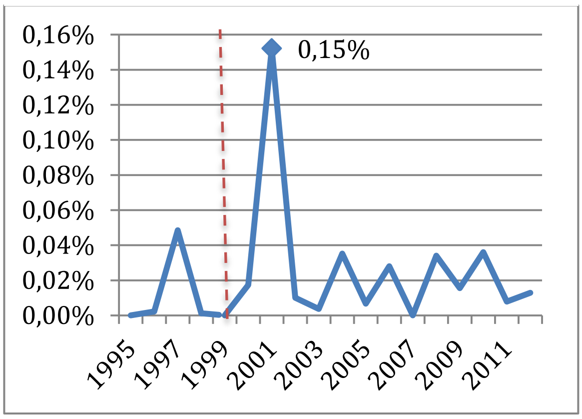
Table 5: Trade in goods with Morocco 1995-2012

Year	Total trade	%change	BoT	Year (cont.)	Total trade	% change	BoT
1995	27,6	*-40%*	-27,6	**2004**	194	*50%*	-51,2
1996	42,8	*55%*	-37,2	**2005**	138,8	*-28%*	-112,8
1997	92,2	*115%*	35,2	**2006**	302	*118%*	-165,8
1998	38,4	*-58%*	-35	**2007**	218,2	*-28%*	-218,2
1999	61,2	*59%*	-61	**2008**	775,3	*255%*	-457,7
2000	86,8	*42%*	-35	**2009**	361,8	*-53%*	-205,8
2001	388,3	*347%*	210,1	**2010**	641,8	*77%*	-237,2
2002	126,1	*-68%*	-85,1	**2011**	849,7	*32%*	-752,5
2003	129	*2%*	-115,6	**2012**	673,9	*-21%*	-511,1

Values in million ISK

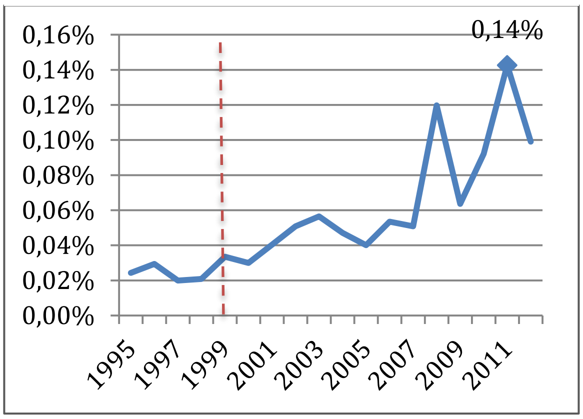
Trade with Morocco increased in the three years after entry into force of the agreement in 1999. But since then trade has been sporadic, especially exports that fluctuate greatly between years. Generally, value of exports has been less than that of import, resulting in a negative balance of goods every year since the entry into force of the agreement except for 2001 when exports values exceeded imports.

Figure 29: Exports to Morocco as a percentage of total exports 1995 - 2012



As presented in figure 29, exports to Morocco are a very small percentage of Iceland's total exports. In several years, exports to Morocco account for less than 0,01% of total exports. In 2001, the only year that balance of goods was positive, almost all the export value came from the sale of a shipping vessel, accounting for 95% of the export value in that year. That resulted the highest percentage of exports at 0,15%. The main exports are industrial products, machinery and mechanical appliances. The fluctuating export figures can perhaps be explained by the adjustment period that ended in 2011. Interestingly exports doubled in value terms between 2011 and 2012.

Figure 30: Imports from Morocco as a percentage of total imports 1995 - 2012



Imports from Morocco grew steadily after the entry into force of the FTA as presented in Figure 30. It reached 800 million ISK in 2011 that accounted for 0,14% of total imports in that year. The main imports from Morocco are fruits and vegetables, clothing, fat and oils.

8.6 Mexico

Official name: Free Trade Agreement Between the EFTA States and the United Mexican States

Entry into force 1 July 2001

Scope: Trade in goods, trade in services and investment

The agreement covers trade in industrial products and fish and marine products. In addition it covers trade in services, investment, competition, protection of intellectual property rights and public procurement. It was the first agreement the EFTA states made with an overseas partner. The EFTA states abolished tariffs on substantially all trade upon entry into force of the agreement, but Mexico was given a 10-year transitional period to lower tariffs in steps on industrial products and fish and marine products. Additionally a bilateral agricultural agreement between Iceland and Mexico was signed and entered into force alongside the FTA.

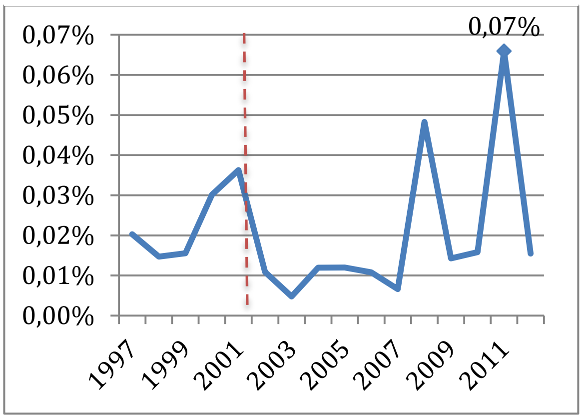
Table 6: Trade in goods with Mexico 1997 - 2012

Year	Total trade	%change	BoT	Year (cont.)	Total trade	%change	BoT
1997	143,3	*-2%*	-90,1	**2005**	282,8	*18%*	-236,2
1998	153,5	*7%*	-113,3	**2006**	357,7	*26%*	-305,3
1999	180,1	*17%*	-135,1	**2007**	429,9	*20%*	-389,7
2000	258,8	*44%*	-168,8	**2008**	1.005,1	*134%*	-554,3
2001	303,0	*17%*	-160,4	**2009**	470,3	*-53%*	-327,5
2002	204,0	*-33%*	-159,6	**2010**	710,8	*51%*	-533,4
2003	170,3	*-17%*	-152,9	**2011**	1.044,7	*47%*	-226,9
2004	239,6	*41%*	-191,2	**2012**	911,7	*-13%*	-716,5

Values in million ISK

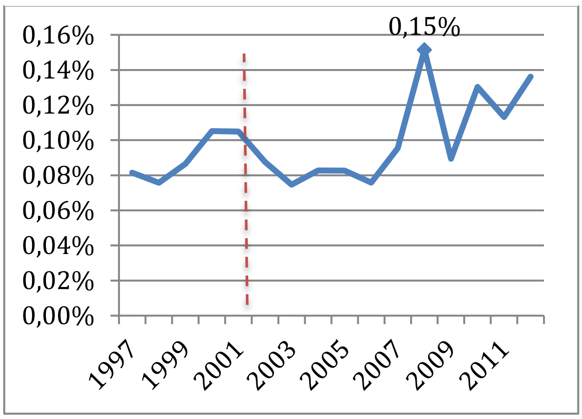
Trade in goods with Mexico decreased somewhat in the three years after the entry into force of the agreement in 2001. Exports to Mexico in the period examined, has always been substantially less than imports, resulting in a negative balance of goods for the last 15 years. In 2005, trade in goods started to increase and both in 2008 and 2011 total trade in goods reached over one billion ISK.

Figure 31: Exports to Mexico as a percentage of total exports 1997-2012



Exports to Mexico fell considerably after the entry into force of the agreement and amounted to 20–30 million ISK until 2008 when exports raised tenfold in value from the year before. Exports to Mexico s a percentage of Iceland's total exports are low, or under 0,05% of total trade except for 2011 when the percentage reached 0,07%. The main products exported to Mexico are scales and machinery for manufacturing.

Figure 32: Imports from Mexico as a percentage of total imports 1997 - 2012



Import of goods from Mexico is much more than exports, both in volume of trade and value. Imports decreased slightly in the two years after the entry into force of the agreement, but have grown since 2004, peaking in at 780 million ISK 2008 that accounted for 0,15% of Iceland's total imports in that year. The main imports from Mexico are machinery, transport equipment and medical appliances.

Statistics Iceland did not record international trade in services until 2009 and thus the data from the entry into force of the agreement with Mexico is not available. Since 2009 export of services from Iceland to Mexico have exceeded imports. Foreign direct investment between the countries at this moment is none and has not been any since 2002.

8.7 Croatia

Official name: Free Trade Agreement Between the EFTA States and the Republic of Croatia

Entry into force 1 April 2002

Scope: Trade in goods

The agreement covers trade in industrial products and fish and marine products. It also includes articles on rules of competition, protection of intellectual property, public procurement state aid and payments and transfers. The agreement has a transitional period of nine years. The EFTA states abolished all tariffs upon entry into force and Croatia had eliminated virtually all custom duties on trade in industrial goods by 2007 and fish and marine products by 2009. A bilateral agricultural agreement between Iceland and Croatia was negotiated and signed at the same time as the FTA.

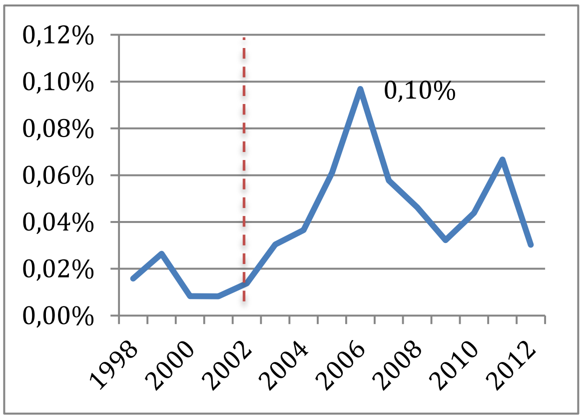
Table 7: Trade in goods with Croatia 1998-2012

Year	Total trade	%change	BoT	Year (cont.)	Total trade	%change	BoT
1998	41,5	*-43%*	1,7	**2006**	737,8	*120%*	-267,6
1999	90,4	*118%*	-13,8	**2007**	338,7	*-54%*	13,9
2000	55,4	*-39%*	-30,6	**2008**	439,8	*30%*	-7,8
2001	39,2	*-29%*	-6,8	**2009**	203,2	*-54%*	119,6
2002	66,3	*69%*	-10,1	**2010**	278,5	*37%*	214,1
2003	114,9	*73%*	-3,9	**2011**	607,8	*118%*	219,4
2004	128,1	*11%*	19,7	**2012**	590,1	*-3%*	-208,3
2005	335,3	*162%*	-98,1				

Values in million ISK

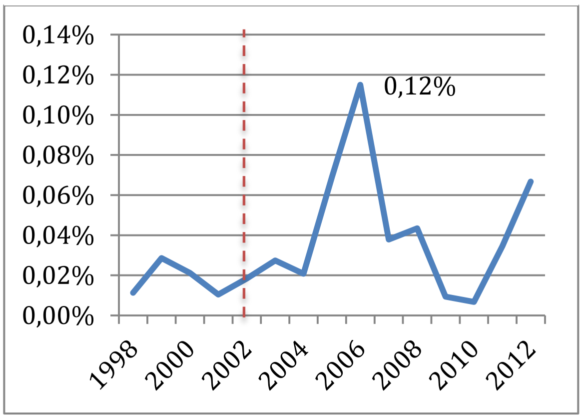
As presented in table 7, trade in goods increased significantly in the years after the entry into force of the agreement in 2002. The value of total trade before the entry into force of the agreement had been under 100 million ISK but both imports and exports rose considerably after the enforcement and have been well above 100 million ISK per year ever since, reaching as high as 740 million ISK in 2006.

Figure 33: Exports to Croatia as a percentage of total exports 1998 - 2012



Exports to Croatia as a percentage of Iceland's total exports since the entry into force of the agreement rose immediately and reached 0,1% of all exports in 2006, worth almost 240 million ISK. In 2011 export values peaked at just over 400 million ISK, but as a percentage of total exports in that year, the exports to Croatia amounted to 0,07%. The main exports to Croatia are fish, mainly coalfish and redfish, pharmaceutical products and mechanical appliances.

Figure 34: Imports from Croatia as a percentage of total imports 1998 - 2012



Imports from Croatia also increased both in value terms and as a percentage of total imports after the entry into force of the agreement in 2002 and reached at their highest point just over 500 million ISK in 2006 or 0,12% of total imports in that year. There was a slump in imports from Croatia in 2009 and 2010 due to a decrease in imports of machinery and electronics. The main imports from Croatia are industrial products such as electrical machinery, iron and steel products and clothing.

8.8 Macedonia

Official name: Free Trade Agreement Between the EFTA States and the Republic of Macedonia

Entry into force: 1 may 2002

Scope: Trade in goods

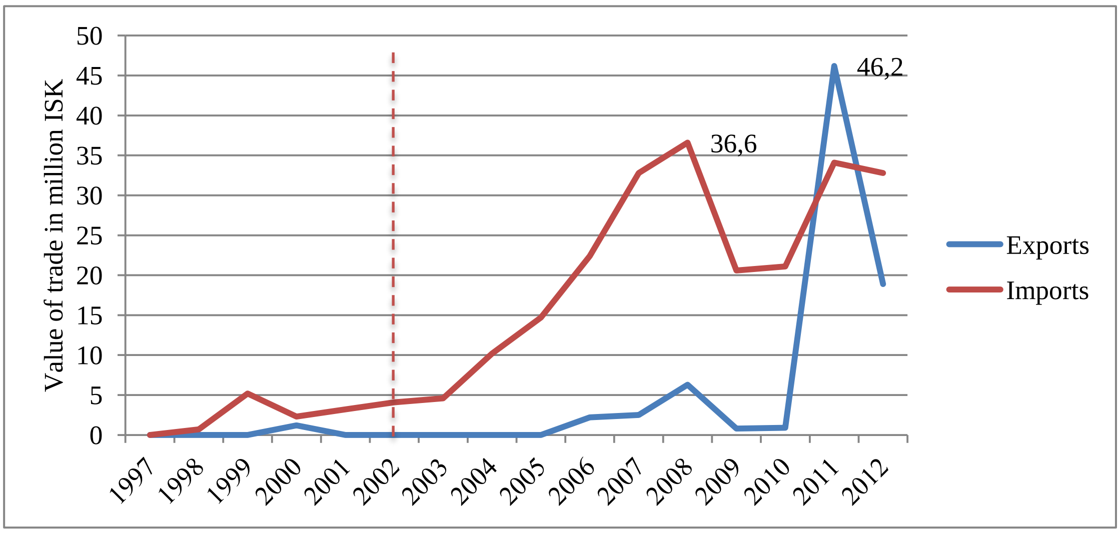
The agreement covers trade in industrial products and fish and marine products. It has a 10-year transitional period, allowing Macedonia to abolish their custom duties towards industrial products originating in the EFTA countries in steps. That transitional period ended in 2011. The agreement also covers other trade-related aspects including competition, intellectual property rights, public procurement and state aid. It also contains provisions for further liberalization of the areas of services and investment.

Table 8: Trade in goods with Macedonia 1997-2012

Year	Total trade	% change	BoT	Year (cont.)	Total trade	% change	BoT
1997	0,0	n/a	0	**2005**	14,7	*44%*	-14,7
1998	0,7	n/a	-0,7	**2006**	24,6	*67%*	-20,2
1999	5,2	*643%*	-5,2	**2007**	35,3	*43%*	-30,3
2000	3,5	*-33%*	-1,1	**2008**	42,9	*22%*	-30,3
2001	3,2	*-9%*	-3,2	**2009**	21,4	*-50%*	-19,8
2002	4,1	*28%*	-4,1	**2010**	22	*3%*	-20,2
2003	4,6	*12%*	-4,6	**2011**	80,3	*265%*	12,1
2004	10,2	*122%*	-10,2	**2012**	51,7	*-36%*	-13,9

Values in million ISK

Figure 35: Trade in goods with Macedonia in 1997 - 2012



Since trade between Iceland and Macedonia is very little, and the volume of total trade is below 0,01% of Iceland's total international trade, import and export figures are presented in figure 35 in million ISK per year. Exports to Macedonia are slim to none except for 2011 and 2012 when exports reached 46 and 19 million ISK due to exports of mackerel in those years. Imports rose steadily after the entry into force of the agreement, reaching a maximum of 36,6 million in 2008. Main imports from Macedonia are clothing and apparel.

8.9 Jordan

Official name: Free Trade Agreement Between the EFTA States and the Hashemite Kingdom of Jordan

Entry into force: 1 September 2002

Scope: Trade in goods

The agreement covers trade in industrial products, fish and marine products and processed agricultural products. A bilateral agricultural agreement with Jordan entered into force at the same time as the FTA. The FTA also contains provisions on rules of origin, competition, intellectual property, public procurement and state aid. The agreement has a 12-year transitional period set to end in 2014, when Jordan is to have abolished virtually all custom duties on industrial goods from EFTA countries. The transitional period for fish and marine products was three years, and ended in 2005 when Jordan eliminated all remaining tariffs on certain fish products from the EFTA countries. The EFTA countries granted duty free access on all imports from Jordan upon the entry into force of the agreement in 2002.

Table 9: Trade in goods with Jordan 1999-2012

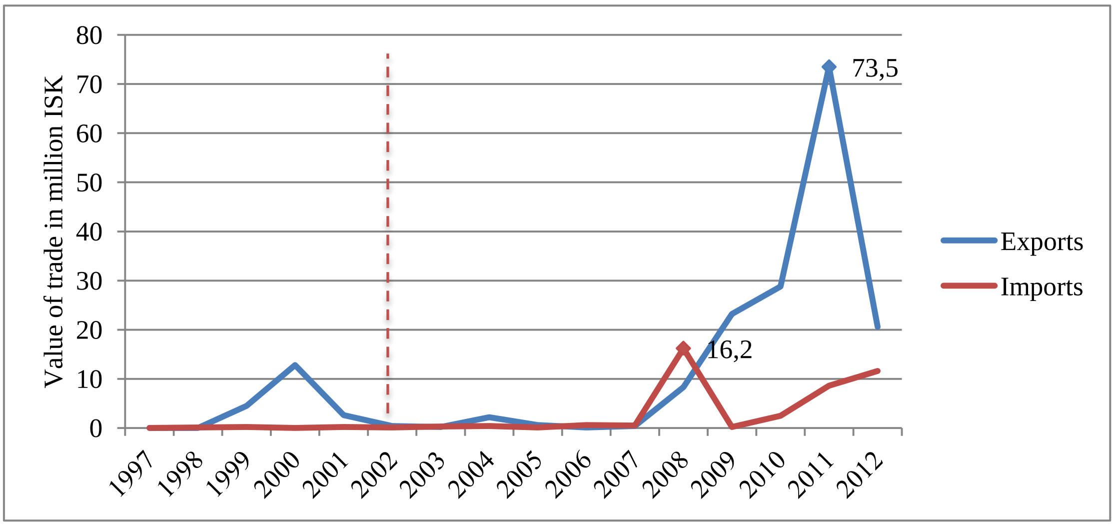
Year	Total trade	%change	BoT	Year	Total trade	%change	BoT
1999	4,7	*4600%*	4,3	**2006**	0,7	*0%*	-0,5
2000	12,8	*172%*	12,8	**2007**	0,9	*29%*	-0,1
2001	2,8	*-78%*	2,4	**2008**	24,5	*2622%*	-7,9
2002	0,5	*-82%*	0,3	**2009**	23,4	*-4%*	23,0
2003	0,5	*0%*	-0,1	**2010**	31,3	*34%*	26,3
2004	2,6	*420%*	1,8	**2011**	82,1	*162%*	64,9
2005	0,7	*-73%*	0,5	**2012**	32,2	*-61%*	9.0

Values in million ISK

As trade with Jordan is a very little and the proportion of trade does not reach 0,01% of Iceland's total international trade at any time during the period examined, import and export figures are presented in figure 36 in million ISK per year.

Exports to Jordan were very little up until 2009 when they started to increase somewhat in value. The devaluation of the Icelandic Krona might have played a role in that growth in export value, but additionally exports of machinery and measuring devices. The exports to Jordan reached 73,5 million ISK in 2011, the majority of that stemming from exports of mackerel and machinery. Imports from Jordan are slim to none only reaching more then 10 million ISK twice in the period, in 2008 when it reached its highest point at 16,2 million due to increased imports of fabricated metals. Other import products from Jordan are vehicles and clothing

Figure 36: Trade in goods with Jordan 1997 - 2012



8.10 Singapore

Official name: Free Trade Agreement Between the EFTA States and Singapore

Entry into force: 1 January 2003

Scope: Trade in goods, trade in services and investment

The Agreement covers trade in industrial products, fish and marine products, processed agricultural products, trade in services, investment, public procurement, competition and protection of intellectual property rights. Additionally Iceland made a bilateral agricultural agreement with Singapore. The chapter on trade in services covers all four modes of service supply, and all service sectors except for air transport. It aims at liberalizing substantially all trade in services within a time-period of 10 years. The provisions on investment cover both access for foreign investors to the respective markets and the protection of investments.

The agreement with Singapore was the first preferential trade agreement made between partners in Europe and East Asia.

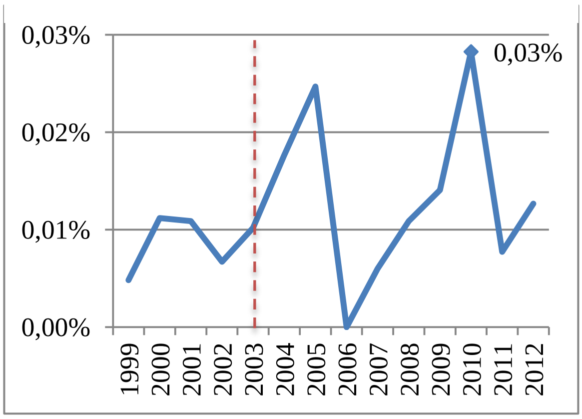
Table 10: Trade in goods with Singapore 2000-2012

Year	Total trade	% change	BoT	Year (cont.)	Total trade	% change	BoT
2000	295,8	*13%*	-262,4	**2007**	480,0	*30%*	-443,4
2001	318,0	*8%*	-275,2	**2008**	440,0	*-8%*	-338,4
2002	316,2	*-1%*	-288,8	**2009**	478,1	*9%*	-337,1
2003	326,1	*3%*	-288,9	**2010**	614,1	*28%*	-296,9
2004	379,8	*16%*	-308,4	**2011**	563,8	*-8%*	-468,0
2005	381,8	*1%*	-285,8	**2012**	2.527,7	*348%*	-2.367,7
2006	370,2	*-3%*	-370,2				

Values in million ISK

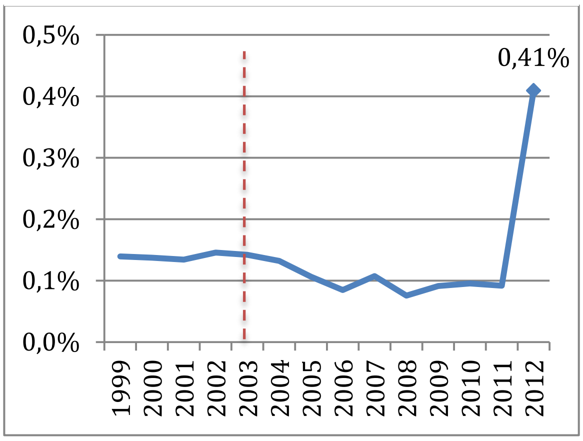
As presented in Table 10, total trade in goods increased somewhat in the years after the entry into force of the agreement. Imports exceed exports by far and the balance of goods is negative the whole period. As an example import values are in the range of hundreds of millions while the export values are tens of millions.

Figure 37: Exports to Singapore as a percentage of total exports 1999 - 2012



Exports to Singapore did increase steadily for the first three years after the entry into force of the agreement in 2003. In 2006 no exports were registered to Singapore (which might be an error in statistics) but increased again after than, reaching their highest point in 2010 of 160 million ISK or 0,03% of total exports in that year. That is also the only year where exports exceeded 100 million ISK. Main exports to Singapore are fish, mainly coalfish and sea cucumber, cod liver oil and chemical products.

Figure 38: Imports from Singapore as a percentage of total imports 1999 - 2012



Imports from Singapore remained around the same in value terms after the entry into force of the agreement, but as a percentage of total imports it actually decreased after 2003. In 2012 imports from Singapore reached their highest point of almost 2,5 billion ISK, or 0,41% of total imports in 2012. That was quintuple the value from the year before, two billions of that caused by imports of alumina. Main imports from Singapore office machinery, computers, radio and telecommunications equipment, colouring and tanning materials.

Trade in services between Iceland and Singapore has mainly been imports of transportation services from Singapore that has increased more than tenfold since 2009. (Statistics Iceland, 2013)

Investment between Iceland and Singapore was none until 2009, but in that year outgoing investment to Singapore amounted for 140 million ISK and 175 million ISK in 2011. (Central Bank of Iceland, 2012)

8.11 Chile

Official name: Free Trade Agreement Between the EFTA States and the Republic of Chile

Entry into force: 1 December 2004

Scope: Trade in goods, trade in services and investment

The agreement covers trade in industrial goods, fish and marine products, processed agricultural products, trade in services and investment, government procurement, competition and intellectual property. Iceland and Chile also signed a bilateral Agricultural Agreement that entered into force at the same time as the FTA.

The chapter on trade in services covers all four modes of service supply and all sectors with the regard that the coverage and extent of liberalization of financial services will be revised on need to basis. (EFTA, 2013)

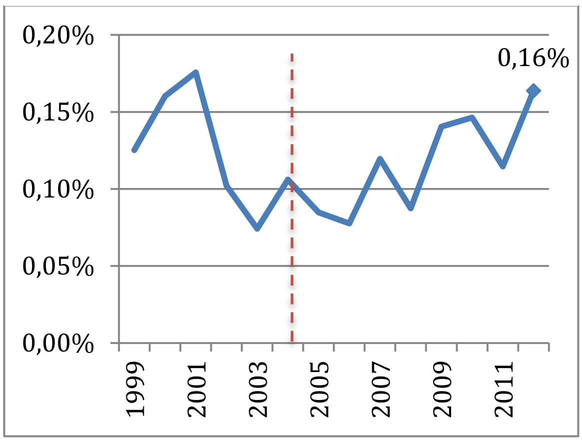
Table 11: Trade in goods with Chile 2000 - 2012

Year	Exports	Imports	Total trade	% change	BoT
2000	239	1.560	1.800	*543%*	-1.321
2001	345	3.841	4.186	*133%*	-3.495
2002	209	163	372	*-91%*	46
2003	136	134	270	*-28%*	2
2004	215	193	408	*51%*	22
2005	165	229	394	*-3%*	-64
2006	188	348	537	*36%*	-160
2007	365	411	775	*44%*	-46
2008	408	486	894	*15%*	-78
2009	703	568	1.271	*42%*	135
2010	821	535	1.357	*7%*	286
2011	711	5.327	6.037	*345%*	-4.616
2012	1.034	5.455	6.489	*7%*	-4.421

Values in million ISK

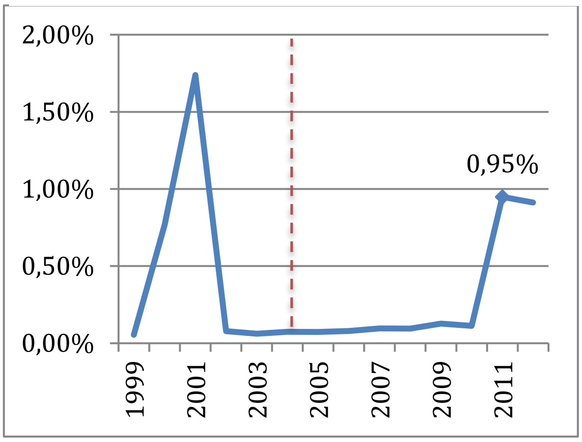
Trade in goods with Chile did not start to increase until a year after its entry into fore in 2004, but has since then grown and reached as much as 6,5 billion ISK in 2012. Both exports and imports rose after 2005, and balance of trade has been both negative and positive in the period. In the last two years however, imports have exceeded exports by 4,5 billion ISK.

Figure 39: Exports to Chile as a percentage of total exports in 1999 - 2012



Exports from Chile as a percentage of total exports have increased since the entry into force of the agreement in 2004 and reached 0,16% in 2012 as presented in Figure 39. Main exports are farmed salmon, electronic scales and machinery for industrial use and fishing gear.

Figure 40: Imports from Chile as a percentage of total imports in 199 - 2012



Imports from Chile increased slowly after the entry into force of the agreement in 2004 and were 0,05 – 0,11% of total imports until 2010 when imports from Chile surged to almost one per cent of total imports in that year or 5,3 billion ISK, the majority of that being the import of a shipping vessel bought in that year. As seen figure 40 demonstrates, in 2012 imports remained a high percentage of total imports. Other import products are beverages (wines), fruits and nuts.

8.12 Tunisia

Official name: Free Trade Agreement Between the States of the European Free Trade Association and the Republic of Tunisia

Entry into force: 1 June 2005

Scope: Trade in goods

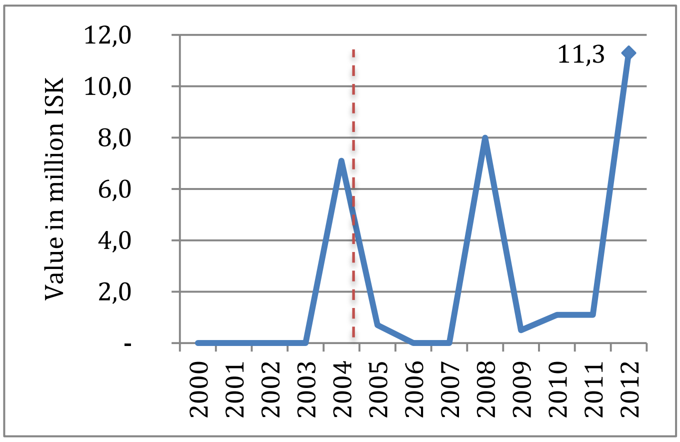
The agreement covers trade in industrial products, fish and marine products and processed agricultural products. Iceland and Tunisia also made a bilateral Agricultural Agreement that entered into force on the same date as the FTA. The agreement covers provisions regarding rules of competition, state monopolies and subsidies, protection of intellectual property, investment, services, government procurement, economic co-operation and current payments and capital transfers.

Table 12: Trade in goods with Tunisia 2001 - 2012

Year	Exports	Imports	Total trade	%change	BoT
2001	-	71,7	71,7	*27%*	-71,7
2002	-	65,5	65,5	*-9%*	-65,5
2003	-	73,5	73,5	*12%*	-73,5
2004	7,1	159,5	166,6	*127%*	-152,4
2005	0,7	248,5	249,2	*50%*	-247,8
2006	-	255,8	255,8	*3%*	-255,8
2007	-	435,4	435,4	*70%*	-435,4
2008	8,0	739,3	747,3	*72%*	-731,3
2009	0,5	704,5	705,0	*-6%*	-704,0
2010	1,1	783,2	784,3	*11%*	-782,1
2011	1,1	957,2	958,3	*22%*	-956,1
2012	11,3	1.090,8	1.102,1	*15%*	-1.079,5

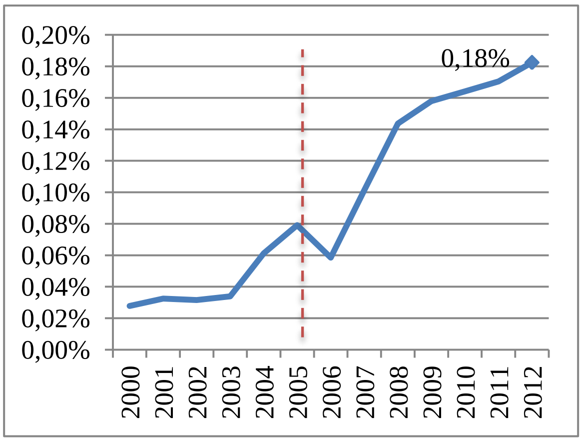
Values in million ISK

Figure 41: Exports to Tunisia in million ISK 2000 - 2012



Trade with Tunisia has increased since the entry into force of the agreement in 2005. Exports to Tunisia have been low and only in 2012 did they exceed 10 million in value terms. In some years no export at all was recorded to Tunisia and since it is so low, exports are shown in million ISK per year in figure 41. The main exports are fish fats and oils.

Figure 42: Imports from Tunisia as a percent of total imports 2000 - 2012



Imports from Tunisia likewise grew steadily after 2005 and reached over 1 billion ISK in 2012 or 0,18% of Iceland's total imports in that year. Imports from Tunisia as a percentage of total imports is shown in Figure 22. The main imports from Tunisia are mineral products, apparel and clothing.

8.13 South Korea

Official name: Free Trade Agreement Between the EFTA States and the Republic of Korea

Entry into force: 1 September 2006

Scope: Trade in goods, trade in services and investment

The agreement covers trade in industrial goods, fish and other marine products and processed agricultural products. A bilateral agricultural agreement and an investment agreement between Iceland and the Republic of Korea also entered into force at the same time as the FTA. Custom duties were eliminated on virtually all industrial products and fish and marine products at the entry into force of the FTA, but some products imported to Korea have a transitional period. The chapter on trade in services includes all four modes of service supply and all sectors. Trade in financial services is outlined in a special chapter in the agreement. The agreement also addresses matters like intellectual property protection, competition, and government procurement.

Trade in goods with South Korea doubled in the four years before entry into force of the agreement in 2006. Iceland has in the period examined always imported more from South Korea than it exported, leaving balance of goods negative. But after the entry into force of the agreement, exports have risen as a percentage of the countries total trade in goods. Two years after the entry into force of the agreement total trade in goods of Iceland and South Korea decreased somewhat due to decreased imports, but as exports increased steadily after 2006, total trade has increased annually since 2010 as shown in Table 13.

Table 13: Trade in goods with South Korea 2002-2012

Year	Exports	Imports	Total Trade	%change	BoT
2002	408	1.707	2.115	*25%*	-1.299
2003	225	1.931	2.157	*2%*	-1.706
2004	358	2.324	2.683	*24%*	-1.966
2005	414	3.715	4.129	*54%*	-3.302
2006	814	3.809	4.623	*12%*	-2.995
2007	1.271	3.860	5.130	*11%*	-2.589
2008	1.322	2.882	4.204	*-18%*	-1.560
2009	1.490	2.176	3.666	*-13%*	-686
2010	1.813	2.282	4.094	*12%*	-469
2011	1.237	3.316	4.553	*11%*	-2.079
2012	1.796	4.220	6.016	*32%*	-2.424

Values in million ISK

Figure 43: Exports to South Korea as a percentage of total exports 2001-2012

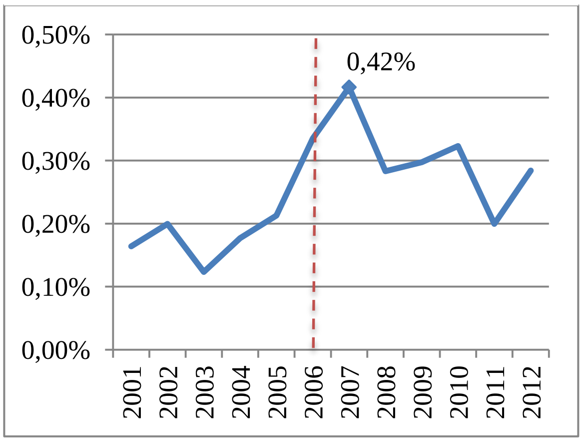
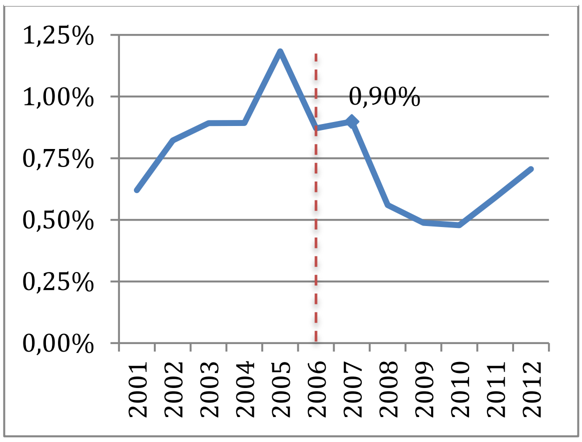


Figure 44: Imports from South Korea as a percentage of total imports 2001-2012



Exports to South Korea have increased steadily in value after the entry into force of the agreement in 2006. A year later export values rose above one billion ISK and accounted for 0,42% of total exports in that year. Although exports continued to rise in value terms, the percentage of total exports decreased after 2007, but remained higher than it had been in the years before the entry into force of the agreement. The main export products to South Korea are fish and marine products such as capelin and redfish, iron, steel and ferrosilicon.

Imports from South Korea are considerably higher than exports. A year after the entry into force of the agreement they reached 3,8 billion ISK or 0,9% of total imports in that year. In the next years imports fell to around half per cent of total imports, but increased slightly in 2011 and 2012. In 2012 imports from South Korea reached its highest value in 4,2 billion ISK. Main imports from South Korea are automobiles, computers and electrical appliances.

In the three years that available data from Statistics Iceland covers (2009–2011), trade in services with South Korea has tripled in three years. Exports of services are around three quarters of total trade in services.

Icelandic Foreign direct investment in South Korea amounted to 2,2 billion ISK in 2011, which are the latest figures. Since 2005, FDI flows to South Korea have been fluctuating, from over 2 billion annually, to negative numbers[7] in 2007 and 2009. (Central Bank of Iceland, 2012)

8.14 Faroe Islands

Official Name: Free Trade Agreement Between the Faroe Islands and Iceland (sometimes referred to as the Hoyvik Agreement)

Entry into force: 1 November 2006

Scope: Trade in goods, trade in services, movement of persons and right to residence, movement of capital and investment

The Hoyvik Agreement is the only non-EU bilateral FTA that Iceland presently has in force. It is very wide-ranging and covers both trade in industrial goods, fish and marine products as well as agricultural products, the last of which is exceptional for Iceland, which usually does not sway away from its strict protection of its agricultural sector. Moreover the agreement abolishes virtually all duties on trade in services, allows for free movement of persons, labour and capital. Additionally it includes provisions on freedom of establishment, competition, state aid, public procurement as well as cooperation in various fields such as culture, energy, environment, natural resource management, communications, tourism and transports. (Ministry for Foreign Affairs, 2006)

Total trade in goods with the Faroe Islands has been quite volatile since the entry into force of the agreement in 2006. In the first year after the EIF total trade

[7] Negative numbers in FDI flows can be explained by one or more factors, e.g. a selling of a company either partially or wholly, high payments of dividends or high net loss

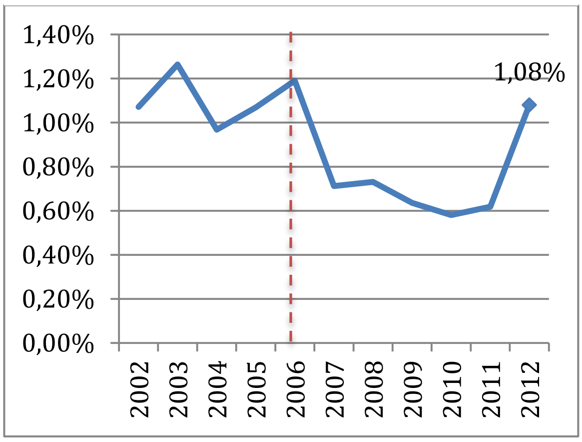
decreased somewhat as shown in Table 14, due to a decrease in exports, but imports increased. In the period examined, exports have generally been substantially more than imports and balance of goods thus positive with the exception of the year 2004. In 2012 trade in goods with the Faroe Islands reached a record high in value of 8,1 billion ISK that amounted to 0,7% of Iceland's total trade in goods in that year.

Table 14: Trade in goods with the Faroe Islands 2002-2012

Year	Total Trade	%Change	BoT	Year	Total Trade	% Change	BoT
2002	2.717,1	-13%	1.660,7	**2008**	5.446,7	47%	1.378,9
2003	3.250,9	20%	1.364,1	**2009**	5.098,5	-6%	1.266,3
2004	4.247,3	31%	-329,1	**2010**	5.369,7	5%	1.144,5
2005	2.602,7	-39%	1.551,5	**2011**	5.204,9	-3%	2.465,5
2006	4.006,0	54%	1.772,8	**2012**	8.124,0	56%	5.521,8
2007	3.694,3	-8%	650,1				

Values in million ISK

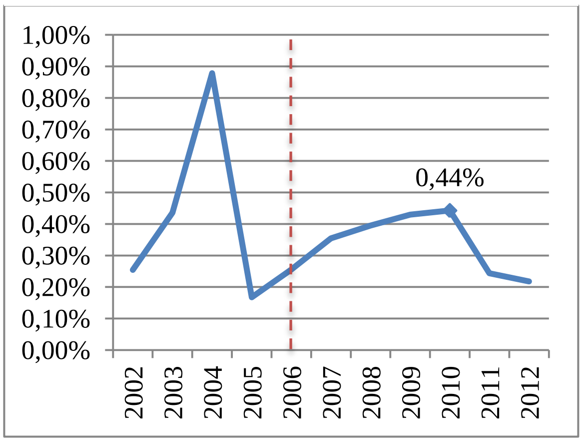
Figure 45: Exports to Faroe Islands as a percentage of total exports 2002-2012



Exports to the Faroe Islands as a percentage of total exports decreased somewhat after the entry into force of the agreement in 2006 as presented in Figure 45. In the year of EIF of the agreement, exports to the Faroe Islands accounted for 1,2% of total exports, but since the agreement took force in November, it is doubtful that the agreement played a role in that high percentage. In the year after, exports to the Faroe Islands fell to 0,7% of total exports and decreased even more in the subsequent years. In 2012 however, exports reached above 1% levels again when exports doubled in value terms from the year before reaching a record high of 6,8 billion ISK. In 2012, the Faroe Islands were the largest export markets of Iceland's FTA partners. The main exports to the Faroe Islands are fish and marine products, mainly herring and capelin, agricultural products, mostly lamb products, and industrial products such as mineral wool, plastic containers, metals and mineral oils.

Imports from the Faroe Islands, in contrast to exports, increased as a percentage of total imports after the entry into force of the agreement in late 2006 as presented in figure 46. In 2010 imports from the Faroe Islands accounted for 0,44% of all imports,

Figure 46: Imports from Faroe Islands as a percentage of total imports 2002-2012



but decreased by half in the two subsequent years both in value and percentage terms. The main imports from the Faroe Islands include processed fish products, unprocessed animal and herbal products and transport equipment.

It seems that the Hoyvik agreement had little, or even slight negative impact on exports of goods, but considerable positive effects on imports from the Faroe Islands. The exception of agricultural products does not seem to have increased imports of fresh products from the Faroe Islands, but then again it does not produce agricultural products in excess and in fact import quite a lot of agricultural products itself, e.g. lamb products from Iceland.

As the agreement covers movement of capital and investment, prohibiting discrimination on the basis of the destination of the capital or place of investment within Iceland and the Faroe Islands, outgoing FDI to the Faroe Island (Table 15) and incoming FDI from the Faroe Islands (Table 16) are examined. Investment in the Faroe Islands had been increasing somewhat in the years leading up to the EIF of the agreement in 2006 and remained afterwards, even though flows in 2008 were negative. Likewise investment in Iceland from the Faroe Islands was consistent after the EIF of the agreement and increased greatly in 2009 with an investment of over one billion ISK. (Central Bank of Iceland, 2012)

Table 15: Outgoing foreign direct investment to the Faroe Islands 2002–2011

Year	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Stocks	653	718	2.630	2.839	4.744	7.124	6.521	12.101	9.827	8.671
Flows	-19	71	1.695	869	1.872	2.285	-4.223	8.896	2.153	1.192

Table 16: Incoming foreign direct investment from the Faroe Islands 2002–2011

Year	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Stocks	6	236	209	228	224	203	186	989	1.021	998
Flows	3	235	-12	-5	-2	-12	-6	1.175	-288	-205

Values in million ISK

8.15 Lebanon

Official Name: Free Trade Agreement Between the EFTA States and the Republic of Lebanon

Entry into force: 1 January 2007

Scope: Trade in goods

The agreement covers trade in industrial products and fish and marine products. Additionally Iceland made a bilateral Agricultural Agreement with Lebanon. There is an adjustment period, set to end by 2015, after which virtually all custom duties of the products within the Agreement's scope originating from the EFTA states to Lebanon are to be eliminated. The EFTA states lift custom duties on Lebanese goods within the agreement's scope upon entry into force. The agreement also has provisions on competition, state aid, intellectual property, services, investment and payments and transfers.

Table 17: Trade in goods with Lebanon 2003-2012

Year	Total trade	%change	BoT
2003	2,4	*9%*	-2,4
2004	6,3	*163%*	-2,3
2005	3,5	*-44%*	-2,7
2006	4,3	*23%*	-4,3
2007	37,8	*779%*	23
2008	22,9	*-39%*	14,3
2009	18,1	*-21%*	6,5
2010	2,3	*-87%*	-1,5
2011	20,6	*796%*	18,2
2012	3,4	*-83%*	-1,4

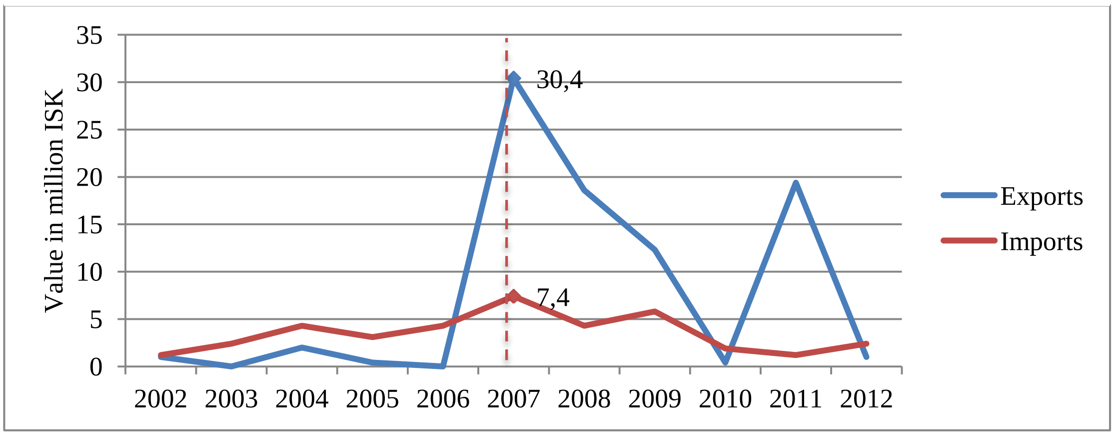
Values in million ISK

Trade in goods with Lebanon is very limited, as presented in Table 17, and does not exceed 0,01% of Iceland's trade, Figure 47 shows trade with Lebanon in million ISK from 2002 to 2012.

Exports to Lebanon were slim to none in the years leading up to the EIF of the agreement in 2006 with total export values in the region of 0-2 million ISK per year. In 2007 exports of scrap metal contributed to the highest value of exports in the period worth over 30 million ISK. Other exports to Lebanon include resold vehicles and dairy products. The EIF of the agreement seems to have had some positive impact on exports, although the export values vary in the years after the EIF.

Imports, like the exports, reached its peak in 2007 at the same year as the EIF of the agreement in 7,4 million ISK. After that imports have not increased so the agreement does not seem to have had a positive effect on imports. Main imports from Lebanon are fabricated metal products.

Figure 47: Trade in goods with Lebanon in million ISK 2002 - 2012



8.16 Egypt

Official Name: Free Trade Agreement Between the Arab Republic of Egypt and the EFTA States

Entry into force: 1 August 2007

Scope: Trade in goods

The agreement covers trade in industrial goods and fish and marine products. Additionally Iceland signed a bilateral agricultural agreement with Egypt that entered into force at the same time as the FTA. The agreement grants Egypt a transitional period to end in 2020, after which virtually all industrial goods originating in the EFTA states will receive duty free access into Egypt. Regarding fish and marine products, Egypt is to lower tariffs on certain products originating in the EFTA states in the first six years after the entry into force of the agreement, and then in steps for the remaining products, aiming at eliminating tariffs on virtually all fish and marine products no later than 14 years after the EIF. The EFTA states grant both industrial, and fish and marine products from Egypt duty free access upon entry into force of the agreement.

The agreement additionally has provisions on intellectual property rights, investment, services, capital movements, government procurement and economic cooperation.

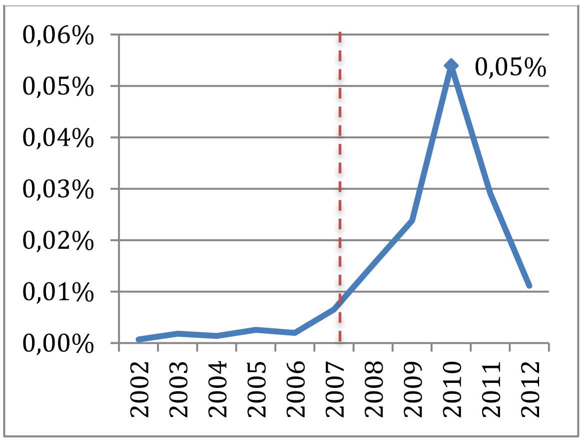
Table 18: Trade in Goods with Egypt 2003-2012

Year	Exports	Imports	Total Trade	%change	BoT
2003	3,3	225,8	229,1	*1.388%*	-222,5
2004	2,8	51,3	54,1	*-76%*	-48,5
2005	5,0	59,1	64,1	*18%*	-54,1
2006	4,8	71,5	76,3	*19%*	-66,7
2007	19,9	171,3	191,2	*151%*	-151,4
2008	71,0	201,5	272,5	*43%*	-130,5
2009	119,3	203,0	322,3	*18%*	-83,7
2010	302,8	205,6	508,4	*58%*	97,2
2011	180,4	193,4	373,8	*-26%*	-13,0
2012	70,3	233,0	303,3	*-19%*	-162,7

Values in million ISK

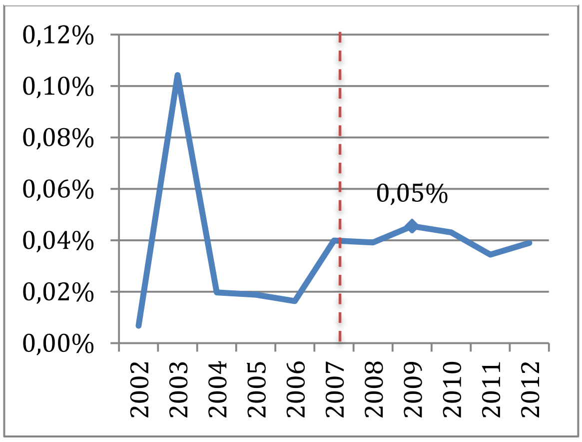
Trade in goods with Egypt has increased in value terms after the entry into force of the agreement in 2007 as presented in table 18. Exports to Egypt are generally lower than imports and the balance of trade thus negative in the period examined save one year, 2010. What is noticeable though is that exports grow as a proportion of total trade in goods after the entry into force of the agreement, in spite of the adjustment period given to Egypt in the agreement and imports held quite steady in value terms after the EIF of the agreement even with custom duties being abolished on virtually all industrial and fish and marine products from Egypt upon entry into force.

Figure 48: Exports to Egypt as a percentage of total exports 2002-2012



Exports to Egypt were very limited before 2007 as presented in figure 48. After the entry into force of the agreement, exports to Egypt started to rise both in value terms as well as a proportion of Iceland's total exports of goods. It reached its peak in 2010 when the value of exports were over 300 million ISK or 0,05% of total exports in that year. That was also the only year in which exports exceeded imports and balance of goods was positive by almost 100 million ISK. The main exports to Egypt are fish, such as mackerel and demersal fish, ferrosilicon, machinery and mechanical appliances.

Figure 49: Imports from Egypt as a percentage of total imports 2002-2012



Imports from Egypt as a proportion of total imports have not changed much after the entry into force of the agreement as presented in figure 49 and table 18. As a percentage of Iceland's total imports it has kept steady at around 0,04 – 0,05%. Main imports from Egypt include fruits and nuts, woven textiles, clothing and apparel.

8.17 South African Customs Union

Official name: Free Trade Agreement Between the EFTA States and the SACU States

Entry into force: 1 May 2008

Scope: Trade in goods

The Southern African Customs Union (SACU) comprises the Republic of Botswana, the Kingdom of Lesotho, the Republic of Namibia, the Republic of South Africa and the Kingdom of Swaziland. The agreement covers trade in industrial goods, including fish and marine products and processed agricultural products. In addition to the FTA, Iceland also signed a bilateral agricultural agreement with SACU that entered into force simultaneously. Custom duties on virtually all industrial products imported into the EFTA states from SACU were abolished upon entry into force of the agreement. Regarding products originating in the EFTA states, the SACU countries eliminate custom duties after a transitional period that varies among the different countries and products. This asymmetrical treatment is due to the difference in economies and business environments of the five SACU members. The agreement additionally includes provisions on competition, intellectual property, investment, government procurement and economic cooperation agreements.

Iceland's trade with the SACU states will be presented as trade with the customs union as a whole, not with each member. However it is pointed out that trade with Lesotho, Botswana and Swaziland is very limited. There is some trade with Namibia but South Africa accounts for the vast majority of SACU trade, both exports and imports.

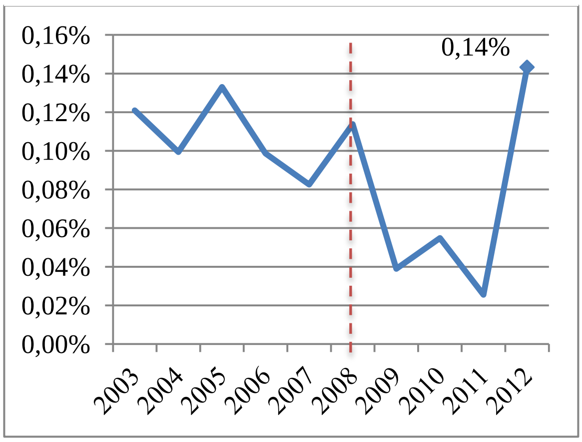
Table 19: Trade in goods with SACU 2004-2012

Year	Exports	Imports	Total Trade	%change	BoT
2004	201,1	345,7	546,8	*24%*	-144,6
2005	258,5	258,2	516,7	*-6%*	0,3
2006	239,5	674,5	914	*77%*	-435,0
2007	251,8	1.074,6	1.326,4	*45%*	-822,8
2008	531,4	579,2	1.110,6	*-16%*	-47,8
2009	194,9	575,3	770,2	*-31%*	-380,4
2010	307,7	779,9	1087,6	*41%*	-472,2
2011	158,1	812,4	970,5	*-11%*	-654,3
2012	904,9	692,2	1597,1	*65%*	212,7

Values in million IS

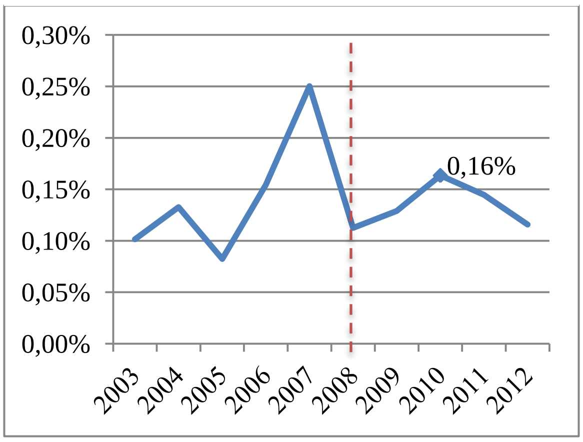
Since the entry into force of the agreement in 2008, total trade has fluctuated slightly, both exports and imports as shown in table 19. There does not seem to be any trend indicating the effects of the FTA's entry into force, in fact it rather seems that trade has lessened since the agreement entered into force compared to trends in Iceland's international trade. Balance of goods with SACU is usually negative, except for 2012 when exports reached a record high of 905 million ISK in value.

Figure 50: Exports to SACU as a percentage of total exports 2003-2012



Exports to SACU decreased somewhat as a percentage of Iceland's total exports after the entry into force of the agreement declining to only 0,03% of total exports in 2011 as shown in Figure 50. In 2012, however, exports increased almost fivefold in value, from the previous year, percentage of exports to SACU effectively reaching 0,14% of total exports in that year. The main exports to SACU are fish, mainly cod and demersal fish, pharmaceutical products, mechanical appliances and fishing equipment.

Figure 51: Imports from SACU as a percentage of total imports 2003-2012



Imports from SACU rose slightly as a percentage of total imports after the entry into force of the agreement in 2008 as presented in Figure 51. Imports reached 0,16% of total imports in 2010. Main imports from SACU are fruits and vegetables, wine (from South Africa) and non-iron metals.

8.18 Canada

Official name: Free Trade Agreement Between Canada and the States of the European Free Trade Association

Entry into force: 1 July 2009

Scope: Trade in goods

The agreement covers trade in industrial products, fish and marine products and processed agricultural products. Additionally Iceland has a bilateral agricultural agreement with Canada. Virtually all industrial products gained duty free access into the respective markets upon entry into force of the agreement with the exception of fishing vessels and floating structures imported into Canada, who have a transitional period of 15 years. The agreement also includes provisions on services and investment, competition, and government procurement that reflect existing WTO obligations in those areas. The parties have held preparation talks regarding the extension of the FTA into areas beyond trade in goods, i.e. to trade in services and investment.

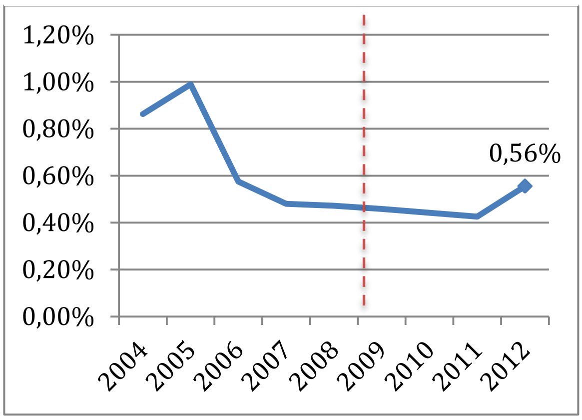
Table 20: Trade in goods with Canada 2005-2012

Year	Exports	Imports	Total trade	%change	BoT
2005	1.923	4.744	6.667	*41%*	-2.822
2006	1.395	12.303	13.698	*105%*	-10.908
2007	1.464	7.583	9.047	*-34%*	-6.119
2008	2.201	5.314	7.515	*-17%*	-3.112
2009	2.294	8.585	10.878	*45%*	-6.291
2010	2.480	8.148	10.627	*-2%*	-5.668
2011	2.641	6.531	9.171	*-14%*	-3.890
2012	3.507	6.599	10.106	*10%*	-3.092

Values in million ISK

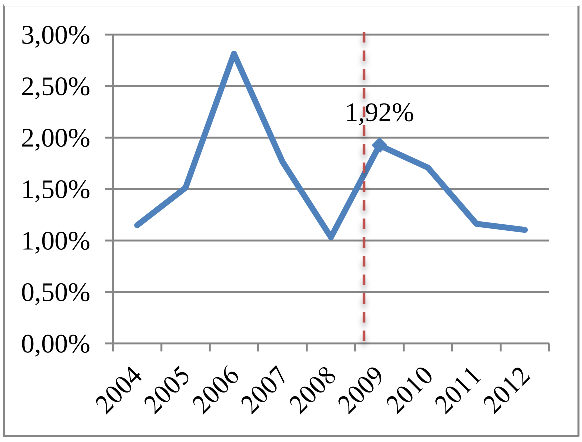
Canada is one of the largest trading partners among Iceland’s FTA partners. However, since the entry into force of the agreement in 2009, trade in goods has not increased noticeably. In fact, the value of total trade decreased in the first two years after the entry into force of the agreement and as a proportion of total trade in goods, trade with Canada in the last two years (2011 and 2012) has been below 1%. The balance of goods has been negative in the recent years, but as a proportion of total trade, exports have increased at the expense of imports since the enforcement of the FTA.

Figure 52: Exports to Canada as a percentage of total exports 2004-2012



Exports to Canada reached as high as 1% of Iceland's total exports in 2005, but had declined by half by the time of the entry into force of the agreement in 2009. Since then, exports have been rather consistent but increased slightly in 2012 when they reached 3,5 billion ISK in value or 0,56% of total exports in that year. The main exports to Canada are fish and marine products, primarily coalfish, cod and langoustine, chemicals for industrial manufacturing, ferrosilicon, machinery and mechanical appliances.

Figure 53: Imports from Canada as a percentage of total imports 2004-2012



Imports from Canada have declined as a percentage of total imports since the entry into force of the agreement in 2009 as presented in Figure 54. In 2009 imports from Canada accounted for almost 2% of Iceland's imports, but have decreased to 1,1% in 2012. Still, Canada is Iceland's largest import market amongst FTA partners with 20% of total imports from the FTA partners in 2012 coming from Canada. In 2006 imports from Canada reached 12,3 billion ISK that translated to 2,8% of imports in that year. Main imports from Canada are frozen seafood, cereals, paper and oil.

8.19 Albania

Official name: Free Trade Agreement Between the Republic of Albania and the EFTA States

Entry into force: 1 October 2011

Scope: Trade in goods

The agreement covers trade in industrial products including fish and marine products and processed agricultural products and abolishes custom duties on virtually all trade in goods upon the entry into force. A bilateral agricultural agreement between Iceland and Albania entered into force on the same date as the FTA. The agreement additionally covers subjects such as intellectual property rights, investment, services and government procurement.

Despite the short experience of the agreement, trade statistics for the preceding years will be examined as well as the year and a half after the entry into force of the agreement.

Table 21: Trade in goods with Albania 2007-2012

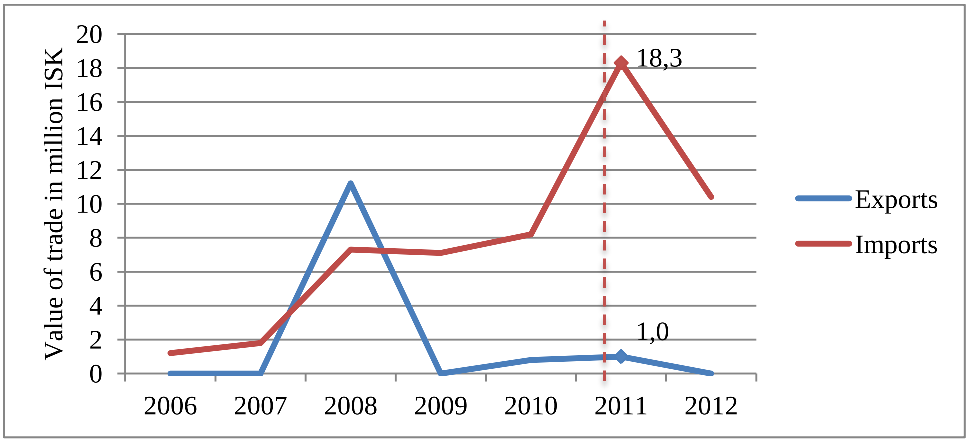
Year	Total trade	%change	BoT
2007	1,8	*50%*	-1,8
2008	18,5	*928%*	3,9
2009	7,1	*-62%*	-7,1
2010	9	*27%*	-7,4
2011	19,3	*114%*	-17,3
2012	10,4	*-46%*	-10,4

Values in million ISK

Trade with Albania is very insignificant and does not reach 0,01% of Iceland's total trade. Thus imports and exports are presented in Figure 54 in value terms (in million ISK). Both imports and exports increased in the year of the entry into force of the agreement, but declined subsequently in 2012.

Exports are slim to none, but reached 11 million ISK in 2008, all of which were exports of pharmaceuticals. Imports have been slightly more than exports, reaching as high as 18,3 million ISK in 2011. The main imports are footwear, clothing and apparel.

Figure 54: Trade in goods with Albania 2006-2012



8.20 Peru

Official name: Free Trade Agreement Between the Republic of Peru and the EFTA States

Entry into force: 1 October 2011

Scope: Trade in goods

The agreement covers trade in industrial goods, fish and marine products and processed agricultural products. Products originating in Peru receive duty free access to EFTA markets from the entry into force of the agreement but a transitional period of nine years is set for products from the EFTA states imported into the Peruvian market. In addition to trade in goods, the agreement also includes provisions on services, investment, intellectual property, government procurement and competition in conformity with relevant WTO Agreements. A bilateral agricultural agreement between Iceland and Peru was concluded alongside the FTA.

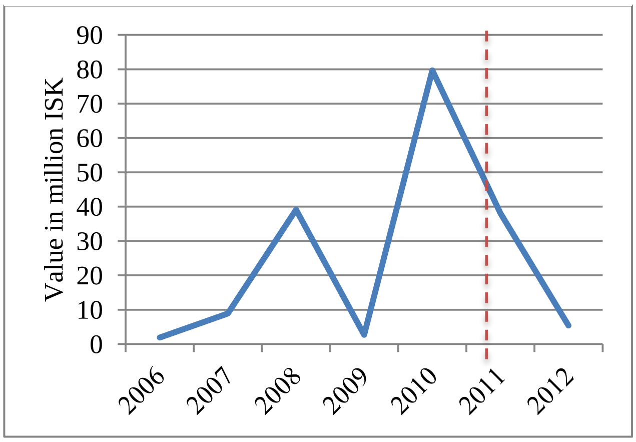
Table 22: Trade in goods with Peru 2007-2012

Year	Exports	Imports	Total trade	% change	BoT
2007	8,9	64	72,9	*124%*	-55,1
2008	39,1	207,8	246,9	*239%*	-168,7
2009	2,7	164,8	167,5	*-32%*	-162,1
2010	79,7	269,7	349,4	*109%*	-190,0
2011	38,1	755,9	794,0	*127%*	-717,8
2012	5,4	1.575,3	1.580,7	*99%*	-1.569,9

Values in million ISK

Trade with Peru increased in the years leading up to the entry into force of the agreement in 2011. Total trade doubled between years after the entry into force of the agreement as is presented in table 22. However there is a vast difference between the import and export values of trade in goods between the two countries. While import figures were in hundreds of million ISK, and reached as high as 1,6 billion in 2012, export figures are not nearly as high, never exceeding 80 million ISK. Thus, balance of trade is negative by hundreds or thousands of millions in the period examined. Due to this imbalance in import and export figures, exports are shown in figure 55 in value terms (million ISK) since they don't reach 0.01% of Iceland's total exports, but import figures are shown as a percentage of total imports in figure 56.

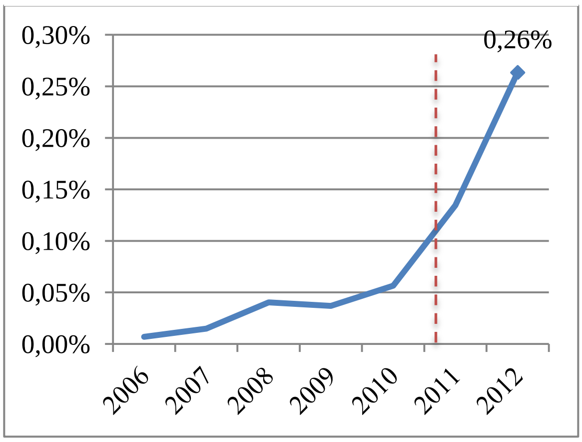
Figure 55: Exports to Peru in value terms 2006-2012



Exports to Peru have been quite volatile in the recent years and there seems to be no specific trend in the years leading up to the agreement, moreover, after the entry into force of the agreement in 2011, exports fell from 40 million to a mere five million in 2012. The main exports to Peru are fishing equipment and medical instruments.

Imports from Peru as a percentage of total imports started to rise in the years leading up to the entry into force of the agreement. In 2006, imports from Peru were only 0,01% of total imports, but had risen to 0,13% in the 2011 when the agreement entered into force. In 2012 imports doubled in value from the year before and the proportion of imports from Peru extended to 0,26% of total imports in that year. Main imports from Peru are fruits and vegetables, textile fibres and oils of animal origin.

Figure 56: Imports from Peru as a percentage of total imports 2006-2012



8.21 Serbia

Official name: Free Trade Agreement Between the EFTA States and the Republic of Serbia

Entry into force: 1 October 2011

Scope: Trade in goods

The agreement focuses on liberalisation of industrial products and fish and marine products and the EFTA states lifted all custom duties on such products from Serbia upon entry into force of the agreement. Serbia abolishes tariffs on said products originating in the EFTA states within an adjustment period ending in 2014. The agreement additionally covers areas such as intellectual property, investment, services and government procurement. Moreover, Iceland made a bilateral agricultural agreement with Serbia in parallel with the FTA.

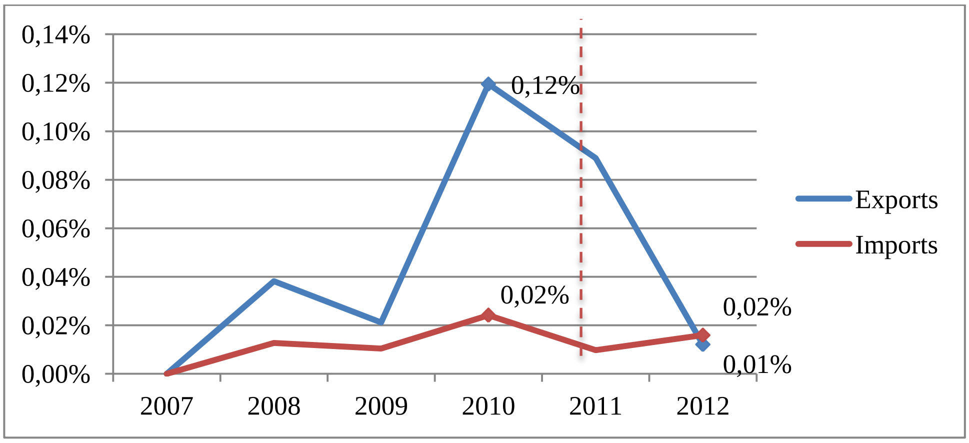
Table 23: Trade in goods with Serbia 2007-2012

Year	Exports	Imports	Total Trade	% change	BoT
2007	0,0-	0,0-	0,0-	n/a	0,0-
2008	178,1	65,4	243,5	n/a	112,7
2009	106,1	46,3	152,4	*-37%*	59,8
2010	670,1	115,2	785,3	*415%*	554,9
2011	551,4	54,6	606,0	*-23%*	496,8
2012	76,2	95,2	171,4	*-72%*	-19

Value in million ISK

No trade was recorded with Serbia in the years 2006 and 2007. After 2008, trade has been volatile and unpredictable, ranging from 150 – 600 million ISK in value. Balance of trade has been positive most of the time, except for 2012 when imports exceeded exports by 19 million. Figure 57 demonstrates both imports and exports to Serbia in terms of percentage of total trade in goods. Exports to Serbia reached 670 million ISK in value in 2010 that was 0,12% of total exports in that year. The whole year after EIF of the agreement, 2012, exports fell to 76 million and only 0,01% of total trade. Imports from Ukraine are typically less in value than imports and peaked in value terms in 2010 with just over 115 million ISK, that only accounted for 0,02% of total imports. Since the agreement has only been in practice since late 2011 it is impossible to articulate on its impact on trade flows.

Figure 57: Trade in goods with Serbia 2007-2012



8.22 Ukraine

Official name: Free Trade Agreement Between the EFTA States and Ukraine

Entry into force: 1 June 2012

Scope: Trade in goods, trade in services and investment

The agreement covers trade in industrial goods, fish and marine products and processed agricultural products. Tariff concessions on such products imported into the EFTA markets, originating in Ukraine were eliminated upon enforcement of the agreement. Tariffs on most products from the EFTA states were likewise abolished upon entry into force of the agreement, while custom duties on the remaining products are to be dismantled over a transitional period of ten years. The chapter on trade in services covers all four modes of service supply and all service sectors except for air traffic. The chapter on investment provides aims at providing a non-discriminatory market access for future investment as well as ensuring fair treatment to existing investments. The agreement also covers areas such as intellectual property rights, government procurement and competition. Additionally a bilateral agricultural agreement between Iceland and Ukraine entered into force simultaneously as the FTA.

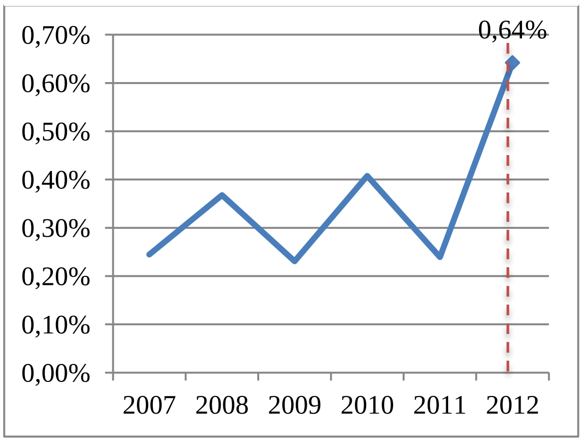
Table 24: Trade in goods with Ukraine 2008-2012

Year	Exports	Imports	Total Trade	% change	BoT
2008	1.717,3	77,4	1.794,7	*104%*	1.639,9
2009	1.154,9	386,8	1.541,7	*-14%*	768,1
2010	2.286,3	73,5	2.359,8	*53%*	2.212,8
2011	1.483,2	64	1.547,2	*-34%*	1.419,2
2012	4.056,1	150,9	4.207,0	*172%*	3.905,2

Values in million ISK

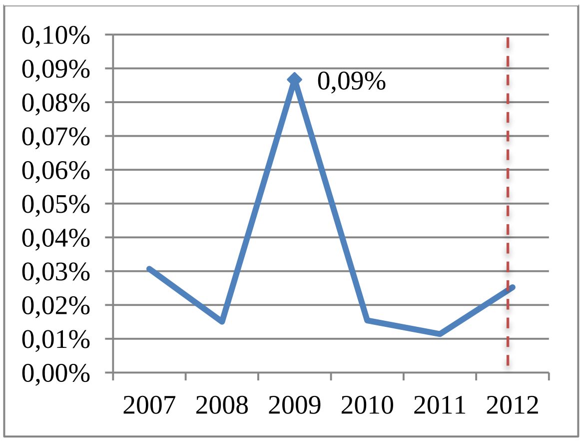
Trade in goods with Ukraine in the four years before the entry into force of the agreement was quite substantial, or 1,5 – 2,4 billion ISK in value. In 2012, when the agreement entered into force, total trade rose by 172% and amounted to a total of 4,2 billion ISK. Exports rose significantly more than imports, leaving balance of goods positive in the recent years, by up to 4 billion ISK. In fact, Ukraine was the second largest export markets of the FTA partner's markets in 2012, with an 18% share of exports to the partners.

Figure 58: Exports to Ukraine as a percentage of total exports 2007-2012



As a proportion of Iceland's total trade in the recent years, exports to Ukraine have been around 0,2 – 0,4% of total exports as figure 58 portrays. In 2012, when the agreement entered into force, exports rose to 0,64% of total world exports worth roughly four billion ISK. Over 95% of exports to Ukraine are fish and marine products, e.g. herring, capelin and blue whiting.

Figure 59: Imports from Ukraine as a percentage of total imports 2007-2012



Imports from Ukraine are only a fraction of Iceland's total imports. They reached 0,09% in 2009, but are generally around 0,02 - 0,03% of total imports as presented in figure 59. main imports from Ukraine are cereals, clothing and apparel.

8.23 Hong Kong

Official name: Free Trade Agreement Between the EFTA States and Hong Kong, China

Entry into force: 1 October 2012

Scope: Trade in goods, trade in services and investment

The agreement is broad-based and covers trade in industrial goods, fish and marine products and processed agricultural goods, trade in services, investment, intellectual property rights, government procurement, competition and trade and environment. Additionally, two bilateral agreements were made between Iceland and Hong Kong, an agricultural agreement and an agreement on labour. Both parties eliminated all customs duties on goods upon entry into force of the FTA. All four modes of service supply are covered in the chapter on trade in services and refer to all service sectors.

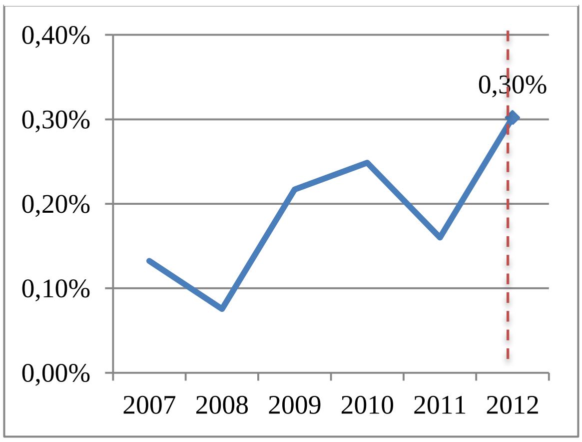
Table 25: Trade in goods with Hong Kong 2008-2012

Year	Exports	Imports	Total Trade	%change	BoT
2008	352,4	1.302,5	1.654,9	*-14%*	-950,1
2009	1.086,7	900,6	1,987,3	*20%*	186,1
2010	1.395,3	1.140,7	2.536,0	*28%*	254,6
2011	992,8	1.014,3	2.007,1	*-21%*	-21,5
2012	1.907,8	843	2.750,8	*37%*	1.064,8

Values in million ISK

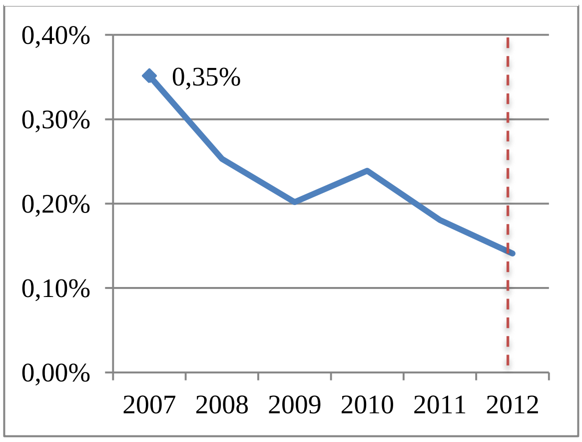
Trade in goods with Hong Kong has increased in value terms since 2008 by almost one billion ISK. The biggest change in the trend of trade in goods with Hong Kong over the last decade is that exports have risen more than imports, resulting in a positive balance of goods in three years as presented in table 25. Before 2008, balance of goods had been negative for several years. Another noticeable trend in Hong Kong trade figures is that in the year of the EIF of the agreement in 2012, exports doubled in value terms between years. Since the agreement entered into force in late 2012, it is unlikely that it contributed to that increase in exports. Actually, trade in the last three months of 2012 (when the agreement had entered into force) was not proportionally higher than in the first nine months of the year.

Figure 60: Exports to Hong Kong as a percentage of total exports 2007-2012



As a percentage of total exports, exports to Hong Kong have grown and reached 0,3% of total exports in 2012. Main exports to Hong Kong are fish, mainly halibut, redfish and sea cucumber, processed animal skins (leather and fur) and diagnostic reagents. Exports of agricultural products have increased in the recent years, mainly lamb and mutton.

Figure 61: Imports from Hong Kong as a percentage of total imports 2007-2012



Imports from Hong Kong, on the other hand, have decreased drastically as a proportion of Iceland's total imports in the recent years as is figure 61 portrays, from 0,35% in 2008 down to 0,14% in 2012. Main imports from Hong Kong include furniture, clothing and apparel, mechanical appliances, computers and telecommunications equipment.

Trade in services in 2009 to 2011 with Hong Kong is presented in Table 26. Figures on individual countries for the year 2012 are not yet available from statistics Iceland.

Table 26: Trade in services with Hong Kong 2009-2012

Year	**2009**		**2010**		**2011**	
Balance of Services	-59		-8,4		124,4	
	Export	Import	Export	Import	Export	Import
Total	**336,6**	**395,6**	**484,7**	**493,1**	**495,4**	**371**
Transport & shipping	86,1	189,8	72,7	279,7	129	124,6
Tourism	94,7	149,6	89,9	148	201,8	180,1
Other business services	105	50,2	3,6	40	14,2	47,6
Other	50,8	6	318,5	25,4	150,4	18,7

Values in million ISK

There have been some investment flows both from Hong Kong to Iceland and from Iceland to Hong Kong in the recent years (Central Bank of Iceland, 2012) that will likely benefit from the investment facilitation in the agreement, but it cannot be assessed whether the agreement has had any investment enhancing effects, both since it has not been in force long enough to establish that, and information on FDI in 2012 will not be available from the Central Bank of Iceland until July 2013.

8.24 Montenegro

Official name: Free Trade Agreement Between the EFTA States and Montenegro

Entry into force: 1 October 2012

Scope: Trade in goods

The agreement covers trade in industrial goods, fish and marine products and processed agricultural products. The EFTA states eliminate customs duties on virtually all trade in those goods originating in Montenegro upon the entry into force of the agreement. Montenegro abolishes tariffs on most products from the EFTA states upon entry into force as well, save for some fish and marine products. Montenegro will gradually dismantle tariffs of the remaining products no later than 2018. The FTA also has provisions on intellectual property rights, investment, services and government procurement based on respective WTO agreements. Iceland and Montenegro simultaneously to the FTA made a bilateral agricultural agreement covering trade in basic agricultural goods.

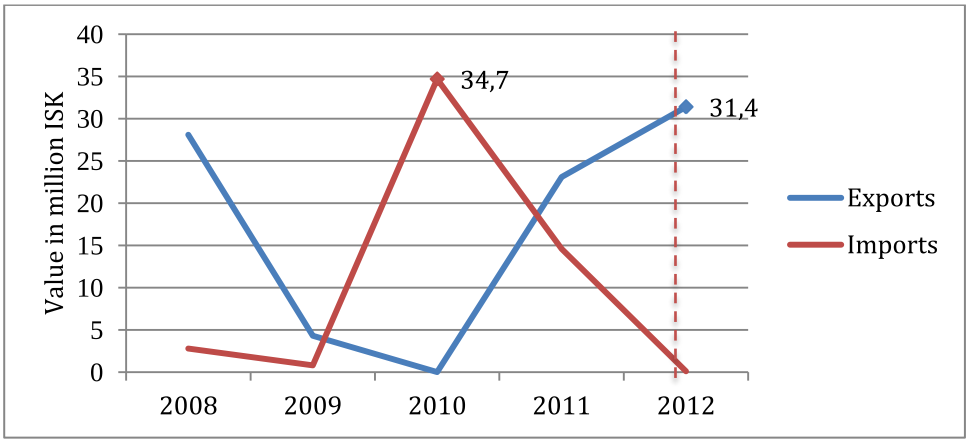
Table 27: Trade in goods with Montenegro 2009-2012

Year	Total Trade	%change	BoT
2009	5,1	*-83%*	3,5
2010	34,7	*580%*	-34,7
2011	37,7	*9%*	8,5
2012	31,5	*-16%*	31,3

Values in million ISK

Iceland's trade with Montenegro has been very little, as table 27 shows, not exceeding 0,01% of total trade in goods, therefore exports and imports are presented in Figure 62 in value terms.

Figure 62: Trade in goods with Montenegro 2008-2012



Exports to Montenegro have fluctuated from none to roughly 30 million in the recent years. Main exports are pharmaceuticals and yarn. Imports from Montenegro have likewise been inconsistent and peaked at just under 35 million ISK in 2010. Main imports from Montenegro are computer components and accessories.

9 Results

Table 28 summarises the results from the previous chapter on individual FTA partners' trade flows in total trade (imports and exports) to determine the extent of the effect of FTAs on bilateral trade flows before and after entry into force of the FTAs. Trade with a given partner is examined as a percentage of Iceland's total external trade four years before entry into force, four years after entry into force as well as eight years and 12 years after entry into force where applicable.

Table 28: Total trade in goods with FTA partners as a percentage of international trade in goods before and after entry into force of an FTA

Country	Volume of trade 4 years before EIF	Volume of trade 4 years after EIF	Volume of trade 8 years after EIF	Volume of trade 12 years after EIF
Turkey	0,09%	0,13%	0,19%	0,40%
Israel	0,13%	0,10%	0,12%	0,12%
Palestine	n/a	n/a	n/a	n/a
Morocco	0,01%	0,03%	0,03%	0,07%
Mexico	0,05%	0,06%	0,05%	n/a
Croatia	0,01%	0,11%	0,03%	n/a
Macedonia	0,000%	0,004%	0,002%	n/a
Jordan	0,000%	0,000%	0,003%	n/a
Singapore	0,08%	0,07%	0,05%	n/a
Chile	0,51%	0,09%	0,53%	n/a
Tunisia	0,02%	0,07%	n/a	n/a
South Korea	0,51%	0,39%	n/a	n/a
Faroe Islands	0,66%	0,52%	n/a	n/a
Lebanon	0,001%	0,002%	n/a	n/a
Egypt	0,06%	0,03%	n/a	n/a
SACU	0,12%	0,13%	n/a	n/a
Canada	1,31%	n/a [8]	n/a	n/a
Albania	0,000%	n/a	n/a	n/a
Peru	0,01%	n/a	n/a	n/a
Serbia	0,000%	n/a	n/a	n/a
Ukraine	0,18%	n/a	n/a	n/a
Hong Kong	0,17%	n/a	n/a	n/a
Montenegro	0,003%	n/a	n/a	n/a

[8] Total trade with Canada had decreased to 0,82% in 2012, three years after entry into force of the FTA

As both the previous chapter on individual FTA partners' trade and table 28 present, trade with Iceland's FTA partners did not generally increase after the entry into force of the agreements. There are several examples of decrease of trade after an FTA is enforced, especially in export figures. When trade statistics before and after entry into force of an FTA are examined, it does not seem to have positively affected trade with the non-EEA FTA partners. However, it is impossible to determine whether the trade had been even less, or would have remained the same, had the FTA not been made.

Since only four of the agreements have been in force for ten years or more, it is impossible to determine whether Baier and Bergstrand (2007, 2009) is applicable in Iceland's case (i.e. that members' trade increases after 10-15 years). When the three countries that meet that criterion are examined, trade increases in the cases of Turkey and Morocco, but remains virtually the same in the case of Israel.

Trade with remaining partners either remains virtually the same or decreases both four years and eight years after EIF and fluctuate slightly between years without any apparent correlation.

The conclusion is that the FTAs examined do not seem to have positively affected bilateral trade flows between Iceland and its non-EEA FTA partners. The results confirm what was established in chapter six, that the EEA is Iceland's largest trading partner and it can be surmised that the EEA agreement remains Iceland's far most important trade agreement.

It must however be emphasised that these results only reflect the case of Iceland's preferential agreements with non-EEA members and do not suggest the overall effectiveness of preferential free trade agreements in general. As discussed in chapter 4.1 on the economic effects of Iceland's EFTA accession, that form of preferential trade integration did indisputably affect Iceland's trade.

10 Discussion

There are several questions that arise when the impact of Iceland’s free trade agreements with partners outside the European Economic Area are studies. As the free trade agreements examined do not seem to increase trade flows with the FTAs examined, and trade has on several occasions decreased following the enforcement of an agreement, questions as to the efficiency of those agreements come up. On several occasions trade decreased after the entry into force of the agreement but in some cases it rose subsequently. The biggest question raised by these results is: Why do we not see rise in trade following the FTAs? There may be several explanations for what seems to be lack of effectiveness of the FTAs and this chapter discusses the author’s reflections on the results.

Firstly, it seems that free trade agreements alone do not stimulate trade where there has not been much trade beforehand. One of the explanations might be lack of awareness of the opportunities that the FTAs create. Icelandic companies could perhaps be better informed on the benefits of the FTAs, both exporting and importing companies that trade in services as well as merchandise. One might say that FTAs are partly created to ensure that Icelandic firms enjoy favourable conditions of trade in (emerging) markets, but it is up to them to utilize these conditions. Better collaboration between the private and the public sectors, e.g. with a marketing campaign following a FTA to promote that market as a possible export or import market, might entice some exporters and importers to look towards new markets.

Secondly, the overwhelming majority of Icelandic trade is with the Member States of the European Economic Area, which of course is a free trade arrangement. Historically the European markets have been by far the most important for Iceland and they continue to be so.

Thirdly, some concerns may be raised regarding the reliability of data on trade flows between Iceland and the rest of the world. Also, as Iceland is such a small market, and trade flows with a specific country are sometimes limited to a few million ISK per year, it is very sensitive to fluctuations. E.g. if one exporter goes under, or decides to change markets, it can highly effect trade figures with the country in question. Moreover, exporters naturally go where they get the best price for their product. If they see a rise in demand for their product in a different market where they can get a better price, they will go there, no matter whether a free trade agreement exists between the countries or not.

Fourthly, Icelandic exports are very homogeneous. Iceland's main exports are fish and alumina. Although the share of fish and marine products has been declining somewhat in the recent years with the rise of the importance of industrial products, it still holds a significant share in exports. Most of these fish products are fresh or frozen, unprocessed products that are exported for further processing in another country, before reaching the end consumer. It may be argued that Iceland is loosing some value in the supply chain, by mainly supplying the raw material instead of creating higher end-value by further processing. The increased share of industrial products as exports stems in large part (in value) from exports of alumina, which as the fish, is exported to foreign markets for further processing and value adding. Both in the case of exports of fish products and alumina, Iceland exports raw material and limits its possibilities for more profits. Icelandic exporters could be gaining so much more by exporting a product that was further down the production line. The FTAs should help Icelandic firms to gain more value, by eliminating tariffs on processed products, and assist in further diversification of exports.

Fifthly, the choice of partners is dictated mainly be the concern to ensure that companies in the EFTA States have similar terms of trade as companies in the EU, as EFTA normally follows in the footsteps of the EU in FTA negotiations. The question arises if Iceland should perhaps form a more consistent policy towards free trade agreements outside the single market as Switzerland has, e.g. by potential growth of markets or countries where Iceland already has substantial trade interests in. Iceland has undoubtedly gained tremendously from its partnership in EFTA, initially opening the European market and in latter years giving it the opportunity make FTAs with several countries that otherwise would probably not have been very interested in negotiating with a small island. Since the EFTA countries are four, Iceland does not have the sole say in which partners to pursue, depending only on the interests of Icelandic exporters or Icelandic consumers. It must follow EFTA's initiatives, which has in to some extent followed the EU, e.g. in the Euro-Mediterranean cooperation. Although many of the EFTA partners are very important markets for Iceland, e.g. Canada, trade with other FTA partners have been virtually none, neither before nor after the emergence of the FTAs. Iceland can to some extent influence the selection of partners within EFTA and the process of the negotiations, but it always has to share the spotlight with much larger markets of Norway and Switzerland. Moreover, Iceland's exports differ from that of Norway, not to mention Switzerland, so there is a risk that Iceland's export interests might be minimized due to the sheer lack of size of its market.

It might be argued as a consequence that Iceland's interests in free trade are best presented in bilateral negotiations, as the agreements with Faroe Islands and China. In that way the agreement will be tailored exactly to Iceland's interests in the partner's market. However, it would undoubtedly prove much more expensive and difficult or even impossible to pursue partners as a small nation, without the backup of the larger EFTA partners.

11 Conclusion

The results of this thesis were somewhat unexpected for the author, who thought the FTA's studied would increase trade to some extent, even though they might not increase it greatly. Therefore it was very surprising to notice that in some cases trade even became less after the entry into force of an agreement. There are in fact more questions that arise than are answered when the results are studied. What was noticeable was that even though Iceland's free trade agreements with partners outside the common market, generally do not seem to increase exports, imports rise after entry into force on some occasions.

The results of this thesis further demonstrate that the EEA agreement is without a doubt Iceland's far most important free trade arrangement. It is perhaps due to that significance that other preferential free trade agreements, like the ones studied in this thesis, are detracted from. However, the trend in both Norway and Switzerland has been that trade with the EEA is decreasing at the cost of other markets, and Iceland has experienced some fluctuations in trade with the area as well. The FTAs with partners outside the EEA can serve as sort of insurance if trade with the EEA decreases for some reason. Then the FTAs discussed can provide opportunities that companies can use as an alternative to trade with the EEA.

Even though the FTAs studied did generally not increase trade flows among its members, the agreements still propose an opportunity for Icelandic companies. Although they may not have utilised the tariff concessions the agreements provide yet, they can choose to do so, or not, in the future. The agreements do create a gain from the trade flows that occur. Moreover, the agreements provide Icelandic companies with an equal competitiveness in the relevant markets as companies located in the EU, as the EU usually has comparable agreements.

Another important aspect of the free trade agreements with partners outside the EEA is the trade consultation platform that is created as a joint committee on the free trade agreement is established. These committees meet on a regular basis to discuss issues in relation to the FTA itself as well as other subjects that relate to the partners' trade. Those meetings can provide a great opportunity to solve any trade related disputes or issues companies might have in the partner's market that could otherwise prove difficult to solve.

11.1 Suggestions for future research

The recently signed free trade agreement with China might prove to become very beneficial to compare with the EFTA FTAs once it enters into force and has gained some experience. As Iceland is the first European country to sign an FTA with China it will be interesting to see whether trade between Iceland and China will increase after the agreement enters into force.

It would be an interesting topic for a future study, to research whether abolishment of custom duties due to the agreements result in a lower price for Icelandic consumers. This would especially be interesting in the case of China, both since imports from China have been increasing recently and its pending entry into force would create an excellent opportunity to record prices before and after the EIF of the agreement.

Another topic for future study could be on the awareness of Icelandic companies of the existence of FTAs and whether they utilise them or not and subsequently study some ways in which the agreements can be better presented towards the private sector.

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